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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. 808

CERTAIN INTERESTS IN PROPERTY IN CHAMPAIGN COUNTY, STATE OF ILLINOIS; CHANUTE GARDENS CORPORATION and CHANUTE APARTMENTS CORPORATION,

Petitioners,

v.

UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

To the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners hereby petition for a writ of certiorari to review the judgments of the United States Court of Appeals for the Seventh Circuit which 1) *affirming* (No. 12497), held *inter alia* that under the Fifth Amendment to the United States Constitution, the measure of just compensation for the taking of long-term leasehold interests in on-base military housing is "market value" of such interests, in the absence of a market and in the absence of comparable sales, and which 2) *reversing* (No. 12498), held that the United States under federal law could and did here condemn leasehold interests subject to a mortgage, though such an estate is unknown to the law of the state where the property is located.

Opinions Below

The opinions delivered in the United States Court of Appeals for the Seventh Circuit are reported at 271 F. 2d 379, 382. The opinion of the United States District Court for the Eastern District of Illinois, reference to which is necessary to ascertain the grounds of the judgments sought to be reviewed, is reported at 165 F. Supp. 474. The opinions of the Court of Appeals and of the District Court are appended hereto as Appendix A and Appendix B respectively.

Jurisdiction

The judgments sought to be reviewed were made and entered on October 21, 1959. An order denying timely motion for rehearing was made and entered on November 24, 1959. On January 29, 1960, Mr. Justice Clark of this Court granted an order extending the time within which to petition for certiorari to and including March 22, 1960. The statutory provision believed to confer on this Court jurisdiction to review the judgment in question is 28 U. S. C. § 1254(1).

Questions Presented for Review

1. When the United States takes by condemnation long-term leasehold interests in federally-controlled on-base military housing (integrated into the base) in excellent condition to continue the same use—such housing having been constructed four years previously pursuant to the Wherry Act (63 Stat. 570) by the condemnee in accordance with Government specifications at a judicially-found reasonable cost of some $9,200,000 to fulfill military need—and there were no comparable sales and no market for such interests and they were not transferable without Government consent, is the measure of just compensation under the

Fifth Amendment to the United States Constitution a "market value" (here found to be $7,100,000), or reproduction cost less depreciation (here found to net $8,750,000), especially when

(a) no owner of such interests had ever been willing to sell them at market value when a statute authorized their purchase by the United States at market value,

(b) after the Department of Defense had found that such interests cannot be valued by normal appraisal methods because their value is dependent upon military need, and a Congressional committee had found that market value would be a "grossly unfair" measure of compensation for such interests, the Congress amended the law to authorize purchase of such interests at a reproduction cost less depreciation;

(c) the Government was at the time of the taking erecting additional (and substantially similar) military housing at the same base at a unit cost of approximately twice the unit price awarded here on the basis of market value?

2. When a condemnation award for Wherry project interests is primarily dependent upon a capitalization of rents, and the Government and the condemnee have four years previously negotiated a rate of return on their investments (averaging approximately 6%), and the Government agency in charge (F. H. A.) has fixed a maximum rate of return upon all Wherry projects (6½%), may the Trial Court in capitalizing rents use an entirely theoretical rate of return higher than both the actual and the legally allowable rate of return, and higher than any capitalization rate testified to as being usable under the method of capitalization purportedly used by the Trial Court?

3. When a condemnation award is primarily dependent upon a capitalization of F. H. A.-controlled rents, which rents should be capitalized—those which would provide a fair and reasonable return, or the actual rents—in the absence of any implementing rent regulations applicable to petitioners, and in a case where the actual rents had been based upon an F. H. A. estimated construction cost ($7,413,000) some 20% less than the actual reasonable cost of construction ($9,200,000), and the F. H. A. had for three years failed to act on an application for increased rentals due to increased construction costs, though in many other cases it had granted increases on such basis?

4. When the United States served a notice of condemnation, stating that a complaint had theretofore been filed in an "action to condemn an estate in fee simple" in leasehold real estate, and the declaration of taking and the complaint purport to condemn all right, title and interest of the lessee arising out of a certain instrument of lease subject to the interest arising out of a certain instrument of mortgage, and the subject real estate is located in a state where a mortgage is a mere lien and a leasehold minus a mortgage is therefore an estate unknown to state law, did the United States purport to condemn a leasehold interest subject to a mortgage; if so, was this a taking of a leasehold minus the amounts due on the outstanding mortgage indebtedness; and if so, did the United States have power and authority to do so?

5. Under all the facts and circumstances of this case, were the petitioners denied just compensation under the Fifth Amendment to the United States Constitution?

Constitutional Provision and Statutes Involved

Amendment V, United States Constitution:

"* * * nor shall private property be taken for public use without just compensation."

The provisions of the statutes involved are lengthy; their pertinent text is set forth in Appendix C hereto. The citations therefor are as follows:

The Wherry Act, 63 Stat. 570.

The 1955 Capehart Act, 69 Stat. 652.

The 1956 Capehart Act, 70 Stat. 1091.

56 Stat. 303 (Section 608, National Housing Act), 40 U. S. C. Sec. 258a.

Statement of the Case

On May 3, 1950, the petitioners were selected by the Air Force to erect the two military housing projects on the Chanute Air Force Base in Illinois, namely, Chanute Gardens and Chanute Apartments, pursuant to the 1949 Wherry Act. Since the Act had specifically eliminated the requirement in prior similar statutes of economic feasibility, the projects were approved on the sole basis of military need for the housing (135a *). Leases for a 75-year term were executed pursuant to which the petitioners were to provide the housing projects in accordance with the plans and specifications of the Air Force and the Federal Housing Commissioner, and pay a nominal rental. The

* Such references are to the pages of the Appendix for Defendants-Appellees-Appellants in the Court below, filed here as part of the record.

leases (216a-236a), which were neither transferable nor assignable without the written approval of the Air Force (224a), provided that the buildings and improvements erected by the lessees "shall be and become, as completed, real estate and part of the leased lands, and public buildings of the United States, leased to Lessee for the purpose of serving the governmental and public purpose of providing military housing in accordance with Title VIII of the National Housing Act" (the Wherry Act) (226a). The provisions of the leases dealing with the contingencies under which the Air Force might control rents (223a-224a, 229a-230a) are set forth in the margin below.*

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* "That if at any time during the term of this lease there is no mortgage insured under the National Housing Act covering the interest of the Lessee and the leased premises are not under the control of the Commissioner, the rental rates for leases granted in accordance with Condition 3 shall be such rates as are agreed upon from time to time by the said Commanding Officer and the Lessee, provided, however, that, in case this lease shall be acquired by the Commissioner and subsequently assigned or sold, the rents shall not be reduced below the schedule of rents then in effect without the consent of the then owner and holder of the leasehold interest." (Par. 4)

"That except as otherwise specifically provided in this lease, all disputes concerning questions of fact or establishment of rental rates or standards of maintenance and repair after there is no mortgage held or insured by the Federal Housing Administration on the property and the leased premises are not under the control of the Commissioner, which may arise under this lease, and which are not disposed of by mutual agreement, shall be decided by the said Commanding Officer, who shall reduce his decision to writing and mail a copy thereof to the Lessee at its address shown herein. Within thirty (30) days from said mailing the Lessee may appeal to the Secretary of the Air Force, whose written decision or that of his designated representative or representatives or board, shall be final and conclusive upon the parties hereto. Pending decision of a dispute hereunder, the Lessee shall proceed with the performance of this lease and in accordance with the Commanding Officer's decision. The provisions of this paragraph shall not be deemed to limit the provisions of Condition 4 of this lease with respect to rents." (Par. 18)

As stated in F. H. A. Military Housing Letter No. 14 (Govt. Exh. 11, 237a-238a), net rental income for Wherry projects was limited to not more than 6½% of the Commissioner's initial estimate of reproduction cost, the initial estimate being subject to revision on the basis of actual construction costs (237a-238a). The net rentals negotiated for petitioners' two projects averaged to approximately a 6% return.

The Korean conflict broke out, and the resulting higher costs meant that the original estimated reconstruction cost ($7,413,452) was substantially exceeded. It was stipulated that the actual cost of construction, exclusive of builders' and architects' fees, was $8,297,969.23 (46a). It was computed that the actual cost, with such fees added, was $9,205,383.71. The projects were completed in 1953.

Because of the unanticipated increase in construction cost, petitioners sought a rental increase on such ground (241a), as allowed by Letter No. 14. This request was not acted upon by the Federal Housing Commissioner, who had awaited the non-forthcoming concurrence of the Air Force (243a). Before the application was acted upon, the Air Force took over the projects under "an honest difference of opinion" (208a) by a bluff (210a), continuing the take-over to the date of taking. Petitioners had no authority to press their demand for rental increase.

In 1955, a new program of military housing was begun under the Capehart Act. This provided machinery for purchase of Wherry projects by negotiations, at a price of fair market value (69 Stat. 652). The Department of Defense the next year wrote Congress as follows:

> "* * * The Department believes that in the determination of purchase price, a formula is superior to independent appraisal because the value of most Wherry projects is dependent upon military need and, therefore, cannot be measured by normal appraisal methods. Valuation by appraisal would vary widely, depending on current financial condition, including anticipated income, while valuation by formula would be based on value of the physical struc-

> tures without regard to financial condition." 1956 Hearings before Subcommittee on Housing, Committee on Banking and Currency, House of Representatives, p. 186.

The resultant Committee report (H. Rep. No. 2363, 84 Cong. 2d Sess., June 15, 1956, p. 44) noting that "* * * as a practical matter no acquisition has taken place", wrote that

> "* * * our studies showed that the fair market value formula contained in present law, although equitable for some projects, would be grossly unfair to most of the Wherry projects, particularly those with a high vacancy ratio."

The resultant legislation (70 Stat. 1091) provided for purchase of Wherry projects at a maximum price based upon a reconstruction cost less depreciation.

In April 1957, without having made any offer for negotiations looking towards the purchase of petitioners' Wherry projects, the Air Force filed a declaration taking "All right, title and interest of" the petitioners "arising out of [the specified leases] * * * subject to the interest of [the mortgagee] * * * arising out of [the specified F.H.A.-insured mortgages]" (30a). On May 8, 1957, notice of condemnation was served upon all interested parties, including the mortgagee, stating that a complaint had theretofore been filed in an action "to condemn an estate in fee simple in" the leasehold property (38a). The complaint, which had been filed on April 29, 1957, set forth the interest in the property to be acquired in precisely the same terms as had the declaration of taking (20a).

The projects, taken under the authority of the Capehart Act and other legislation (19a), were in very good condition, better than when first constructed (204a-205a), and above the average of all Wherry projects (196a). They were taken to continue their military use (19a-20a), along with new additional similar units to be constructed at the

same base under the Capehart Act (197a-198a) which authorized their construction at double the amounts authorized under the Wherry Act.

A jury trial was waived. Experts testified for the Government and petitioners. The Government expert Kuehnle contended that there had been two comparable sales which consisted of sales of stock of lessees of housing projects. He testified that he derived his capitalization rates primarily from these allegedly comparable sales. The other Government expert, Dunn, testified as to capitalized value based upon what a hypothetical willing buyer would pay, but giving no consideration to the existence of a hypothetical willing seller (23A).* Their capitalization rates were based on an "equity method" of capitalizing rentals after deductions for mortgage payments (49a, 59a, 66a). Testimony was also had as to original cost, reproduction cost, and depreciation.

The Government experts testified that the military must concur with the F.H.A. in any rental increases (64a), and that F.H.A. rules and regulations were that the dollar amount of the net return established in the original processing could not be increased because of increased construction costs (63a-64a, 75a, 76a), various F.H.A. Military Housing Letters being submitted as showing such controls (No. 53, Govt. Exh. 17, 249a-250a; No. 64, Govt. Exh. 18, 252a). Actually, there were no F.H.A. rules or regulations applicable to petitioners' projects implementing F.H.A.'s power to control rentals under the Wherry Act; the unpublished Military Housing Letters did not have the force of law**; and F.H.A. did have a policy of granting rental in-

* Such references are to pages of the Appendix hereto.

** *Memorandum from Joel C. Wise, Esq., Chief Counsel, Rental Housing Section of F.H.A., Legal Division, to Mr. R. W. Jefferson, dated March 12, 1957:*

"The administrative letters * * * do not have the full force and effect of law as distinguished from the Administrative Rules and Regulations which are published in the Code of Federal Regulations."

creases because of increased construction costs—and had granted them in many cases.*

The trial court capitalized actual rentals, writing that the Air Force controlled rentals under the leases. It found that there was no evidence of comparable sales. In determining just compensation, the trial court ruled, it would consider "All the elements which go to make up fair cash market value" (20A), and made findings upon the factors which it deemed relevant thereto. These were original

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* *F.H.A. Comments on GAO Draft Report on Review of Military Housing Project Rentals (Wherry)*, transmitted to Mr. A. T. Samuelson, Director, Civil Accounting and Auditing Division, U. S. General Accounting Office, by Herman F. Masson, Commissioner, on Jan. 24, 1957. Said the F.H.A., at pp. 10-11 of *F.H.A. Comments*: "The [GAO Draft] report states that Eatontown Gardens, Projects Nos. 031-80002, 3 and 4, Eatontown, New Jersey, were granted an increase in rents due to an increase in construction costs in excess of the FHA estimates of replacement cost, contrary to Military Housing Letter 64. This letter sets forth instructions only with respect to increases in rents due to increases in operating expenses or taxes. Since the inception of the Rental Housing program, where an increase in construction cost has been encountered, recognition could be given to an increase in rent upon satisfactory justification. Section 608 Rental Housing Letter No. 145 and Military Housing Letter No. 14 specifically authorize increases in rents on account of increases in construction costs and are not inconsistent with Military Housing Letter No. 64. Furthermore, in a memorandum addressed to Mr. Franklin D. Richards, then Commissioner, dated June 23, 1950, outlining the "Procedure for establishing approved rents in Rental Housing", covering Sections 608, 207, Title VIII, it is stated that 'Rental increases may be given consideration where it is demonstrated that during construction increased costs beyond the control of the owner were encountered and such increased costs are established to the satisfaction of the insuring office'."

The Wise *Memorandum* shows that such "rental increases were granted in ten cases * * *".

(Thermofax copies of the *F.H.A. Comments* and the *Wise Memorandum* have been recently procured through the Library of Congress at the request of a member of Congress, since the same are not publicly available. They are on file in the office of Herbert Monte Levy, Esq.)

reasonable cost (found to be $8,200,000) without builders' and architects' fees, which with builders' and architects' fees added amounted to some $9,200,000. The trial court found reproduction cost to be about $9,500,000, depreciation to be approximately $750,000, leaving a net replacement cost of around $8,750,000. In determining capitalization of renal income, the trial court stated that amortization of mortgage indebtedness should not be deducted as an expense item, and ruled as follows:

> "The capitalization of net rents to determine value would vary materially according to the multiplier to be used upon the determined net rentals. The applicable multiplier varied from Roe's [defense expert] 14.5354 to Dunn's 6.8. The court taking into consideration an estimated net rental and multiplier which would satisfy both a willing buyer and a willing seller finds that based upon the capitalization of rent the value of the premises is about $6,950,000." (23A)

The Court did not state which multiplier (the inverse of the capitalization rate) it used. As shown mathematically *infra*, p. 26, it used a capitalization rate of greater than 6½%.

It thereupon found just compensation to be in the amount of $7,100,000. It also found that the entire leasehold interest had been condemned.

Some two months after the decision, the Government moved for an order declaring the judgment satisfied, setting forth an agreement dated some three months after the taking under which the Government secured a release from the mortgagee to petitioners, and purported to make itself liable on the mortgage notes (350a-359a). The motion was denied.

Petitioners here appealed from the decision of the trial court on the question of whether just compensation had been awarded; the Government counter-appealed, claiming

that the interests condemned were subject to the mortgages, and that interest should run on the leasehold interests minus the amount of outstanding mortgage indebtedness. The Court of Appeals affirmed the finding of just compensation in the amount of $7,100,000, holding that market value was the test in the absence of comparable sales, but reversed the denial of the motion for an order declaring the judgment satisfied.

Issuance of the mandate has been stayed below and will under Rule 28 of the Court below be automatically stayed pending final determination here.

REASONS WHY THE WRIT SHOULD BE GRANTED

I. Review should be granted to resolve serious and novel questions affecting at least thirty pending Wherry condemnation cases involving potential awards of some $160,000,000, especially in view of the executive and legislative views that the measure of just compensation used below is improper and grossly unfair.

This is the first of at least thirty pending condemnation cases involving Wherry projects,[1] erected at an estimated cost of some $160,000,000.[2] Since no reported decision except the one below has laid down the standards for measuring just compensation of Wherry projects, review here is warranted if for no other reason than to avoid a multiplicity of appeals. Any erroneous decisions would be most costly

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[1] Letter from Office of the Assistant Secretary of Defense to Samuel Goldstein & Sons, Feb. 23, 1960. These figures are as of Dec. 31, 1959. They do not include other Wherry's not then condemned but which may or must be condemned under existing law. See p. 15, *infra*.

[2] This is based on a total cost price of some $173,000,000 for 33 such projects purchased by the Government, the average being adjusted to reflect the higher cost here. See Report to the Congress of the United States, *Review of the Acquisition of Wherry Housing by the Department of the Air Force*, by the Comptroller General of the United States, Aug. 1959; p. 46.

to the United States because of the running of interest at 6% pending final appellate determination.

Speaking of one question below (also raised here as No. 5), the Government said:

> "As noted in the conclusion to our opening brief (p. 78), because of the number of similar cases outstanding, it is of particular importance that this Court [the Court of Appeals] spell out [the law] in no uncertain terms * * *." Reply Brief of the United States as Counter-Appellant, p. 17.

It is obviously of even greater importance that the Supreme Court spell out the measure of just compensation in Wherry condemnation cases and the methods of fairly determining that compensation. Until then, it can be anticipated that the Questions Presented here will arise again and again in Wherry condemnation cases, for they are inherent in every Wherry case.

Moreover, as shown, *supra* (pp. 7-8), the executive department (through the Department of Defense) has stated that the value of Wherry projects cannot be determined by normal appraisal methods (*i.e.*, market value), and Congress has enacted legislation based upon a congressional committee report which found that valuing Wherry projects at market value would be "grossly unfair" to owners of most Wherry projects. The decision below thus constitutes a judicial determination that the proper standard for measuring just compensation is one which the executive rejects and which the legislature apparently deems "grossly unfair". While neither the Congress nor the executive can determine what is just compensation,[3] this unbecoming conflict on a constitutional question between the legislative and executive departments on the one hand, and a lower federal court on the other, seems as persuasive a reason for granting certiorari as is a conflict between federal courts of appeal, which alone may be a sufficient reason for granting certiorari.

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[3] *Monongahela Navigation Co. v. United States*, 148 U. S. 312.

II. In ruling that market value constitutes just compensation in the absence of comparable sales and in the absence of a market—and irrespective of whether market value is an appropriate or the best measure of value here, of the difficulty of finding it, or of whether a manifest injustice results from its application—the Court below decided federal constitutional questions in a way in conflict with applicable decisions of this Court. Its ruling that market value is the test to be applied in a no-market situation because the interests involved are not sufficiently unique has no support in law or in fact. In rejecting reproduction cost less depreciation as the measure of value for Government-sponsored projects taken to continue the same public use, the Court below rendered a decision in conflict with those of other federal appellate courts and in a way in conflict with applicable decisions of this Court.

A. There were no comparable sales, there was no market for Wherry interests, and they were non-marketable.

The Trial Court found that there were no comparable sales, and the Court of Appeals affirmed this finding. We note, too, that at the times when federal law had provided for purchase by the Government of Wherry projects at "market value", no transfers ever occurred (*supra*, p. 8).

But not only was there no market for Wherry projects and no comparable sales—they were in fact non-marketable. None had ever been sold.[4] And the governing leases pro-

[4] While the long-term leaseholds had never been sold, there were in fact two sales of stock in corporations owning housing projects, which the courts below correctly held to be non-comparable sales. *In re United States Commission to Appraise Washington Market Co. Property*, 295 Fed. 950, 954 (D. C. Cir. 1924), *pet. for cert. dismissed*, 265 U. S. 598. The possibility of such stock sales being made, without any necessity for Government approval, further negates any possibility of sales of the leasehold interests.

vided that they could not be alienated without federal consent (224a). That any such consent would have been sought or would have been forthcoming was most unlikely—as the Government itself noted below, "* * * it was declared a matter of public policy that Wherry housing should be transferred from private hands to ownership by the military." Brief of the United States, p. 25, fn. 9.[5]

B. This Court has repeatedly ruled in applicable decisions that market value is not the test of just compensation when there is no market or in other special circumstances present here.

The Court below cited *Olson* v. *United States*, 292 U. S. 246, 255, for the proposition that the practical standard of just compensation is "market value fairly determined". However, there was a clear market for the interests condemned in *Olson*, and no question was involved in that case of the measure of compensation in the absence of a market. In every case decided by this Court thereafter, however, this Court has ruled that market value is *not* the test in the absence of a market—and, furthermore, that it is *not* the test if market value be difficult to find or under other special circumstances. The cases are legion.

1. *The decisions of this Court that market value is not the test in absence of a market or in other special circumstances:*

> "Where, for any reason, property has no market, resort must be had to other data to ascertain its

[5] The Government cited, among other sources, H. Rept. No. 2363, 84th Cong., 2d Sess., p. 44; 3 U. S. Code & Cong. Admin. News, 84th Cong., 2d Sess., 1956, p. 4551.

value * * *." *United States* v. *Miller*, 317 U. S. 369, 374.*

"In the ordinary case, for want of a better standard, market value, so called, is the criterion of that value. *In some cases this criterion cannot be used, either because the interest condemned has no market value, or because, in the circumstances, market value furnishes an inappropriate measure of actual value.*" *United States* v. *General Motors Corp.*, 323 U. S. 373, 379 (Emphasis added.)

"The conventional criterion for determining what is 'just compensation' for private property taken for public use is what it would bring in the free, open market. * * * *But there must be a market to make the criterion available.*" *United States* v. *Felin & Co.*, 334 U. S. 624, 629-30. (Emphasis added.)

"The Court in an endeavor to find working rules that would do substantial justice has adopted practical standards, including that of market value, * * * *But it has refused to make a fetish even of market value, since that may not be the best measure of value in some cases.*" *United States* v. *Cors*, 337 U. S. 325, 332 (Emphasis added.)

"But when the property is of a kind seldom exchanged, it has no 'market price,' and then recourse must be had to other means of ascertaining value, including even value to the owner * * *." *Kimball Laundry Co.* v. *United States*, 338 U. S. 1, 6.

* Paradoxically, the Court below relied almost completely on *Miller* (*Olson* was the only other case relied on) in holding that market value controls even when there is no market. We submit that it was able to arrive at this startling result only by applying a quotation (317 U. S. at 374-5) dealing with the ordinary case—where there is a market—to the extraordinary case where no market exists, and thus reaching the conclusion that because market value may not be found with nicety in the ordinary situation, it can and should be found even when there is no market because market value is only an informed guess anyhow in the ordinary situation. The Court below thus uses *Miller* to arrive at a principle of law directly *contra* to Miller.

"* * * But when market value has been too difficult to find, or when its application would result in manifest injustice to owner or public, courts have fashioned and applied other standards." *United States* v. *Commodities Corp.*, 339 U. S. 121, 123.

2. *Even if there were a market, other special circumstances would render the market value test inappropriate here.*

As the cases just cited show, market value is not the test —even where there is a market—if (a) "in the circumstances, market value furnishes an inappropriate measure of actual value" (*General Motors*), or if it is not "the best measure of value" in the particular case (*Cors*), or (b) "when market value has been too difficult to find, or (c) when its application would result in manifest injustice to owner or public" (*Commodities*).

As to (a): that there is a serious and substantial question as to whether market value of a Wherry project is an appropriate or the best measure of value, appears from the fact that the Department of Defense has rejected market value as an appropriate measure of valuation for Wherry projects, and that Congress has found market value to be a "grossly unfair" measure of such valuation. Moreover, the very concept of valuing an integrated part of a military base at a "market value" is conceptually repugnant. To treat military housing as an ordinary commercial property susceptible of exchange in the market place is most inappropriate in view of the fact that the military housing was constructed in accordance with government specifications to fulfill military need, and not on the basis of ordinary commercial feasibility[7]; to treat it as susceptible of exchange in

[7] "The primary difference between the mortgage insurance proposed under the new Title VIII [the Wherry Act] and that available under Section 608 [of the National Housing Act] is that the bill does not require the [FHA] Commissioner to make a determination of acceptable risk." House Rept. No. 854, June 20, 1949, as printed in 3 U. S. Code Congressional Service, 81st Cong., 1st Sess. at p. 1758.

a private market when it was never sold on a private market approaches the realm of unreality—especially when the granting of consent therefor would seem to be inconsistent with the public policy of government acquisition of Wherry projects. To attempt to find the price that a willing buyer would have paid a willing seller (*United States* v. *Miller, supra*) in a free and open market (*United States* v. *Felin & Co., supra*) must surely be an inappropriate attempt when there is not and never has been either a willing buyer, a willing seller, or a free and open market.

As to (b): that market value is not the test when it is too difficult to find. Here, the Government's experts proceeded on the theory that the purchaser of Wherry projects was buying a stream of income[8]. But these experts had a practical difficulty in fixing the present value of that income—for they could have no idea whatsoever what any person would purchase that income for when it came from a Wherry project. In short, there was no experience whatsoever to determine without too much difficulty what such a cash flow was worth.

The Government experts attempted to surmount these difficulties by imaginary hypotheses, based solely on their opinions, unsupported by any facts or circumstances—a test of little value[9]. They merely gave unsupported opinions as to what yield per annum a purchaser would expect from his Wherry investment—e.g., 12% (111a)—not based on any market for Wherry projects which alone could have showed the yield the market would expect. (In

[8] This was of course an inappropriate approach in itself, for they did not attempt to value the leasehold, but instead arrived at a "cash flow" after improperly deducting payments for amortization, interest, and mortgage insurance (see *supra*, p. 27). This Court has held, however, that "the full value of the buildings and improvements is attributable to the * * * interest" of a Wherry project lessee. *Offutt Housing Company* v. *County of Sarpy*, 351 U. S. 253, 262.

[9] *Clark* v. *United States*, 155 F. 2d 157, 160 (8th Cir., 1946).

determining what a hypothetical willing purchaser would pay a hypothetical willing seller on a basis of capitalization of rents, Government expert Dunn stated that "he gave no consideration to the existence of a hypothetical willing seller" (23A *infra*); and the only other Government expert testifying on this question (Kuehnle) based his capitalization rate on two sales of stock interests (56a) which the courts below held to be non-comparable sales (fn. 4, *supra*).) (See also, p. 21, *infra*.)

Nor did the District Court state how it arrived at its final figure for market value; the Court of Appeals was unable to discern how it was done.

As to (*c*): that market value is not the test when "its application results in manifest injustice to owner or public." The injustice to the owners here could hardly be more manifest. These projects had a *reasonable* cost of construction of some $9,200,000; four years later the property—still in fine shape and the best of its kind (196a) and taken to continue its use—is found to have the value of $7,100,000. Of the original reasonable $9,200,000 investment, only $7,100,000 is left! What happened to the missing $2,100,000? It did not vanish in obsolescence; the buildings were in excellent shape, and condemned to continue their use. Depreciation was found to be only some $750,000. This accounts for $750,000 of $2,100,000—but leaves $1,350,000 unaccounted for. Surely there is manifest inequity here.

Put it another way: the cash investment over and above mortgage loans was some $2,720,000—with amortization payments, it amounted to $3,050,000. The cash returned on condemnation over and above the outstanding mortgages was only some $954,000. Where did the missing values go? Is this not "manifest injustice"?

Moreover, the Government at the time of taking was erecting similar additional military housing on the same

base at about twice the unit price received on the condemnation here, though the new units are only slightly larger than the ones condemned. The Government, through a condemnation forcing a loss of about 1½ million dollars to petitioners, is securing military housing from petitioners at a cost of only half its present construction costs. This windfall to the Government at petitioners' expense is a manifest injustice.

C. The ruling below that the interests here condemned must be measured by market value because not sufficiently unique has no support either in law or in fact.

Ruled the Court of Appeals: "We are not satisfied that the property interest taken in this case is so unique as to take it outside the general rule" of market value.

The decisions of this Court fail to reveal any doctrine or decision holding that an interest must be of some (unstated) degree of uniqueness before it is to be taken outside the general rule of market value. This novel doctrine of the Court below is, of course, necessarily inconsistent with the many precedents we have previously cited which hold the market value test inapplicable for reasons other than uniqueness.

But even if uniqueness be the criterion, we submit, then Wherry projects are about as unique interests as one can find. It may be enough to say that we have been able to find only two cases in which similar interests were involved (in both of which the federal courts awarded reproduction cost less depreciation, see *infra*, pp. 22-23). But we note the following unique aspects of Wherry projects: (1) they consisted of private leasehold interests in government-owned military housing "in the middle of" a military base (76a) (unprecedented in our history so far as we are aware); (2) they were erected in accordance with government specifications; (3) they were integrated into the military base; (4) under the statutory scheme for their erec-

tion, there was no consideration of economic soundness, but only of military need; (5) rents and operations were controlled by the Government; (6) they were not alienable without government consent; (7) no sales of such interests had ever occurred anywhere; (8) no owners of such interests were ever willing to sell them at market value. The interests here condemned were surely *sui generis*.

Perhaps the Court below merely meant that these were leasehold interests returning income which could be capitalized and were therefore not sufficiently unique. The answer to this: this type of leasehold interest was so unique as to give no basis whatsoever for determining what rate of capitalization should be used in valuing the expected return.[10] For there was simply no experience on which to base even an expert's opinion. Income from this kind of source had never been traded on the market and there was therefore no yardstick, no criterion, to measure what investors would pay for this income.

D. In rejecting the test of reproduction cost less depreciation as the measure of value for long-term leasehold interests constructed under Government sponsorship for public purposes and condemned to continue such use, the Court below rendered a decision in conflict with those of other federal appellate courts and in a way in conflict with applicable decisions of this Court.

Quite apart from the fact that "Cost of reproduction is a method of valuation usually resorted to 'where the character of the property is such as not to be susceptible

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[10] Cf. *Kimball Laundry Co.* v. *United States*, 338 U. S. 1, 17, n. 8. "The importance of varying in accordance with varying risks the percentage at which income is capitalized to obtain business value has been emphasized * * *."

Here, not only were the risks (or absence thereof) unique, but so was the type of real estate from which the income stemmed.

to the application of the market value doctrine' ",[11] the federal courts have uniformly held that the proper measure of just compensation is reproduction cost less depreciation when the real estate was—as here—constructed under Government sponsorship on Government property for public purposes and is taken to continue such use.

In *Thayer-West Point Hotel Co.* v. *United States*, 64 F. Supp. 565 (Ct. Cls. 1946), *modified on other grounds*, 329 U. S. 585, residential accommodations had been constructed by a long-term lessee for military authorities on a military reservation, the Government owned the property and controlled the rentals—a virtual duplicate of the situation here. Though the proceeding was not in eminent domain, the case involved determination of "just compensation" pursuant to contract. After rejecting the applicability of the market value test because "There was no market to which resort might be had for adjudging value" and

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[11] *Riley* v. *District of Columbia Redevelpp. Land Agency*, 246 F. 2d 641, 644 (D. C. Cir. 1957) (sitting *en banc*); *accord*, *Brooks-Scanlon Corp.* v. *United States*, 265 U. S. 106, 125; *De La Rama S.S. Co.* v. *United States*, 206 F. 2d 635 (2d Cir., 1953). *In De La Rama*, *supra*, where there had been no comparable sales, the Second Circuit did not seek market value, and net reproduction cost (225% more than original cost three years earlier) controlled. Here, the search for a "market value" resulted in the trial court weighting net reproduction cost at less than 10% the weight it gave to capitalized value.

The Court below cited *obiter dictum* purportedly to the contrary of the *en banc* ruling of the Court of Appeals in *Riley*, *supra*. It cited *United States* v. *49.735 Square Feet of Land, etc.*, (92 F. Supp. 384, 388, aff'd. 193 F. 2d 180, cert. den., 343 U. S. 928) for this proposition: "Defendant's contention that the district court should be confined to a consideration of reproduction cost less depreciation is not well taken in this case, and such method generally is held to be one of the least reliable indicia of market value." But it was not market value we were seeking to indicate—since there was no market. Our contention is that, in the absence of a market, reproduction cost less depreciation is itself the best measure of value—and the writer of the *United States* v. *49,375* opinion relied upon here below did not disagree. See 92 F. Supp. at 388, n. 2.

because the realty was a Government military reservation (64 F. Supp. at 568), the Court considered "the history and circumstances" and placed "main reliance * * * upon sound value, that is, reconstruction new less depreciation * * *" (considering only original cost in addition thereto).

The Court of Appeals of the District of Columbia has taken the approach that total reliance must be had upon reproduction cost less depreciation in such circumstances. In *In re United States Commission to Appraise Washington Market Co. Property*, 295 Fed. 950 (D. C. Cir., 1924), *pet. for cert. dismissed on Government's motion*, 265 U. S. 598, a market for public purposes on Government property was constructed by a long-term lessee according to Government specifications, and the property was condemned to continue its use—the identical situation as in the case at bar, save that petitioners here constructed military housing on a military base rather than a market. The Court of Appeals, stressing that "the government in taking over this property is doing so with the view of continuing the business, not for the purpose of destroying the plant" (*id.* at 953), reached this conclusion:

> "We are of opinion that the only just and legal method of arriving at the fair value of the property * * * is to determine first the cost of reproduction based upon present values and deducting therefrom the amount of depreciation." (*Id.* at 954-5)

But we urge that the legal picture is still more deserving of clarification in view of the question of the applicability of prior decisions of this Court which may yield even other results. 1) In *Olson v. United States*, 292 U. S. 246, 256, this Court stated: "Nor does the fact that it [the property] may be or is being acquired by eminent domain negative consideration of availability for use in the public service." If this be an element of value, was it not ignored below? Is the criterion of value the need of the military—as ruled by the Defense Department (see *supra*, pp. 7-8)—, and if so,

how is that need to be valued—at the cost of reconstruction by the Government? 2) "The rule is well settled that, in condemnation cases, the most profitable use to which the land can probably be put in the reasonably near future may be shown and considered as bearing upon the market value * * *." *McCandless* v. *United States*, 298 U. S. 342, 345. But the only use to which this land could legally be put is military housing—and surely that cannot be measured on a market value basis. What basis to use, then—the value to the military? Is this the amount it saves by taking over the project? But this would run headlong into the doctrine that gain to the taker is irrelevant. 3) But "gain to the taker" is "rejected as a measure of public obligation" because it "may be wholly unrelated to the deprivation imposed upon the owner" [*Kimball Laundry Co.* v. *United States*, *supra*, 338 U. S. 1, 5], *e.g.*, the taking of land of little value to use in a valuable and different way. But does this doctrine apply when the property is taken to continue the same use?—for then gain to the taker and the deprivation on the owner are not unrelated, but are indeed identical. 4) Thus, where the taker acquires going-concern value, as when a utility is taken over for continued government operation and the owner is thus put out of business, "the taker fully occupies the owner's shoes", the going-concern value must be paid. *Id.* at 12. What is the going-concern value of military housing?

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The Government will doubtless cite to this Court its dictum in *United States* v. *Toronto Nav. Co.*, 338 U. S. 396, 403, that reproduction cost is an inappropriate measure of value "when no one would think of reproducing the property", then go on to cite testimony that nobody would think of reproducing this property under present conditions of financing (the favorable FHA loans available under Wherry legislation no longer being used for military housing), and conclude that reproduction cost

is thus an inappropriate measure of determining value. The answer is fourfold: (1) in *Toronto,* this Court was referring to property which no one would reproduce because it was obsolescent, not because it was economically unsound to do so;[12] (2) Wherry projects were erected without any concern for economic feasibility, and to take them on a basis of economic feasibility would be forbidden—"the transaction cannot be torn from the context" [*Felin & Co., supra,* 334 U. S. at 632], and the Government, having invited the construction on a non-economic basis, may be estopped from securing a valuation on an economic basis [cf. *Monongahela Navigation Co.* v. *United States, supra,* where the measure of just compensation "rested primarily upon the doctrine of estoppel, as this Court has in several cases since pointed out." *Omnia Co.* v. *United States,* 261 U. S. 502, 513-4]; (3) it cannot be said that "no one would think of reproducing the property", since the Government itself was building new and similar housing (the units being slightly larger) on military bases, including the one here—and no one else could do that building under the law at the time of the taking; (4) if it be inappropriate to award reproduction cost when "no one would think of reproducing the property", it is just as inappropriate to award market value when no one ever was willing to sell this type of property at market value.

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[12] This is the full context of the quotation, dealing with an obsolete ship: "Original cost is well termed the 'false standard of the past' where, as here, present market value in no way reflects that cost. So with reproduction cost, where no one would think of reproducing the property." *Ibid.*

III. In approving capitalization of net rental income at a higher rate of return than the ceiling rate of return (6½%) allowable in Wherry projects, and in the absence of competent evidence on which such a higher rate of return could be found, all in the absence of a market, the Court below rendered a decision in a way in conflict with applicable decisions of this Court.

The trial court capitalized net rental income at a rate greater than 6½%.[13] In so doing, however, the trial court improperly capitalized rentals at a greater rate than that allowable for Wherry projects, and at a rate which had no support in the record.

A. *The rate of return allowable by law—and its effect.* When the Government establishes ceiling prices, they normally control the determination of market value. *United States* v. *Commodities Corp., supra.* Here we have the converse of *Commodities*—the Government here established a ceiling rate of capitalization when it ruled that the maximum rate of capitalization for Wherry's was to be 6½% (Govt. Exh. 11, 237a-8a). If *Commodities* was bound by the Government's ceiling prices, must not the Government be bound by its ceiling rate of return—especially since there was no

[13] The trial court's capitalized value was $6,950,000. If the court had used a 6½% capitalization rate, the net rental value used by the court must have been $451,750 (6½% x $6,950,000). However, the Government expert Kuehnle testified to a net rental value of $472,885 [$321,515 plus $119,370 (14A) plus $32,000 (16A)]. If the court used Kuehnle's figures as the net return to arrive at its capitalized value of $6,950,000 (and his figures of net rental income were the only Government figures alluded to by it), the court's rate of return was some 6.9% or more than 6½%. If the court considered any greater net rentals by reason of Kuehnle's improperly deducting amortization payments from income (23A), or for any other reason, then to find a capitalized value of $6,950,000 the rate of return would have had to be even higher than 6.9%.

market for Wherry leaseholds which would pay a greater rate of capitalization? Can the Government say, when authorizing a Wherry, we will not allow you greater than a 6½% rate of return, which we deem reasonable; and then, upon taking a Wherry, take it at a higher rate of return than it itself set as reasonable? Is there a different rule when the Government takes than when it contracts? This Court has held that the doctrine of estoppel applies against the Government in condemnation cases. *Omnia Co.* v. *United States, supra.*

Besides holding that ceiling prices prevail in determination of value, this Court has also held that that price controls which is fixed voluntarily between the industry and the condemnor [*Vogelstein & Co.* v. *United States*, 262 U. S. 337] or between the particular condemnee and the condemnor.[15] *Hanson Co.* v. *United States*, 261 U. S. 581; *United States* v. *New River Collieries Co.*, 262 U. S. 341.

B. *The use of a capitalization rate higher than 6½% had no foundation in the record.* The trial court purported to use the "free and clear" method of capitalization—capitalizing net rentals before deductions for mortgage amortization payments,[16] mortgage interest and insurance payments—rather than the incorrect "equity" method of deducting all mortgage payments as expense items, capitalizing, and adding the amount of the mortgage.

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[14] Cf. Messrs. Justices Reed, Black and Murphy, concurring in *United States* v. *Felin & Co.*, 334 U. S. at 643: "Under the circumstances of this case, any other value than the ceiling price is illusory."

[15] Since the actual rates of return negotiated for petitioners' projects was less than 6½% (averaging about 6%), this in turn raises another serious and novel question upon which this Court has not passed: which controls—the ceiling rate of return, or that actually negotiated between the parties?

[16] Babcock, *Valuation of Real Estate* (1st Ed.), 387; *DeLuz Homes* v. *County of San Diego*, 45 Cal. 2d 546, 569, 290 P. 2d 544, 558. Said the trial court here: "Amortization of mortgage indebtedness is not an expense item, and to treat it as such would improperly reduce the valuation" (23A).

But the only rate of capitalization given for valuation on a free and clear basis was the one given by petitioners' expert, the Government experts having refused to give any valuation or multiplier on a free and clear basis, rejecting and repudiating any method of valuation except the incorrect equity method (49a, 59a, 66a). Thus, no applicable rate of capitalization existed in the record save those testified to by petitioners' expert. The use of such rate of capitalization (6½%) applied even to the trial court's estimate of net rentals ($472,885) yields a figure for capitalized value some $400,000 higher than the judicially-found $6,250,000. The error here was in using as "applicable" (to quote the trial court's own words) (23A) a multiplier whose very basis was properly rejected by the trial court—in using a finding of a multiplier which was both baseless in fact and law. Such a composite conclusion of fact and law may, even if not clearly erroneous, be reversed in constitutional cases. *United States* v. *Felin & Co., supra*, 334 U. S. at 639-640; *Konigsberg* v. *State Bar of California*, 353 U. S. 252.

IV. In capitalizing only actual rentals rather than the fair and reasonable rentals which should have been granted under law, the Court below rendered a decision in a way in conflict with applicable decisions of this Court.

The trial court, erroneously finding that the Air Force controlled rentals,[17] completely failed to consider what ad-

[17] Neither statute nor regulation can be found requiring military acquiescence in rental increases. Though the trial court quoted *verbatim* provisions of the leases (12A-13A) which it held "requir[ed] Air Force consent for rental increases" (23A), these provisions giving the Air Force such power came into effect only "*if* at any time there is no mortgage insured under the National Housing Act" (Par. 4) and "*after* there is no mortgage held or insured by the Federal Housing Administration" (Par. 18) (Emphasis added). But there were such mortgages at all times prior to the taking—and they were not to be paid off for more than three decades.

justments should have been made in the rentals because of the 20% increase in construction costs, capitalizing only actual rentals.

But it was the FHA which did control the rentals, and though it had failed to grant increases here because of improperly seeking Air Force acquiescence, its policy was to grant rental increases on the grounds of increased construction costs.[18] And it was under a statutory mandate to grant reasonable rental increases because of increased construction costs: when Congress enacted the Wherry Act, with specific language providing for FHA rent controls, it must be conclusively presumed to have had knowledge that the New Jersey Supreme Court had approved the FHA's construction of identical language re FHA rent controls (in § 608 of the National Housing Act) to mean that FHA had the power and authority to grant reasonable rental increases due to increased construction costs. By reenacting the same statutory language in reference to Wherry's, the Congress must be held to have approved the said New Jersey interpretation in *Fox* v. *Stuyvesant Town*, 31 N. J. 2d 408, 66 A. 2d 47. Moreover, though FHA had promulgated no regulations re rent controls applicable to petitioners' projects, any regulations adopted would have had to be both "reasonable" and "consistent with the statute." *Manhattan Co.* v. *Commissioner*, 297 U. S. 129, 134. And this requirement would have required the granting of increased rents due to increased construction costs, as held in *Fox*. Surely petitioners cannot be held to have lost their right to reasonable rentals by virtue of FHA failure to adopt regulations (though the Wherry Act had directed the FHA to adopt regulations), and subsequent failure to implement even its own policy of granting reasonable increases.

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[18] See *supra*, p. 10, footnote. While the increased costs would have had to be established, there is no such problem here, for the trial court found the *reasonable* cost of construction to be $9,200,000, though the original estimated cost was $7,413,452.

If the rentals existent in the projects were not in fact fair at the day of the taking—and the Government experts admitted they did not provide a fair return (73a-74a, 287a-288a)—it is manifest that any condemnation award based upon a capitalization of such unfair rents is *per se* unfair and therefore cannot equal just compensation. Though this would seem axiomatic, it is of course reinforced by the cases. 1) If increases should have been granted, then the past rentals were not significant, for "Past [rentals] are significant only when they tend to reflect future returns." *United States* v. *Toronto Nav. Co.*, 338 U. S. 397, 403. 2) In *United States* v. *Commodities Corp.*, *supra*, it was ruled that special hardship or unfairness in a particular case arising from price control should be considered in determining just compensation. Here, the failure of F. H. A. to exercise its duty of fixing fair rentals clearly resulted in unfairness and hardship to petitioners. 3) The Government may not unfairly and illegally fix rents and then have such rents used as a basis for ascertaining just compensation. This goes too far. As this Court stated (per Holmes, J.), "The general rule at least is, that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Pennsylvania Coal Co.* v. *Mahon*, 260 U. S. 393, 415.[19] Here, the failure to even consider petitioners' application for rental increase not only deprived petitioners of their right to receive fair rents before the taking, but—going uncorrected by the courts below—resulted in a capitalization based upon illegal and unfair rents.

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[19] Cf. *United States* v. *Powelson*, *supra*, 319 U. S. at 284: "The United States no more than a state can be excused from paying just compensation measured by the value of the property at the time of the taking merely because it could destroy that value through appropriate legislation or regulation."

V. The United States did not attempt to condemn an interest "subject to a mortgage". But in any event the United States may not condemn a non-existent property interest, nor does just compensation consist in making an award for an interest in land minus the amount of the mortgage, leaving the condemnee liable for payment. The decision contra, below, was in a way in conflict with applicable decisions of this Court.

So far as we are aware, this case presents the first instance in which it has been held that the United States may condemn an "interest in real estate" which is an interest unknown to the state whose law creates the real estate interests. The questions arising from such a purported taking have grave implications not merely for the taking of Wherry projects (or other projects financed with large F. H. A.-insured mortgages) but for all condemnation cases.

A) *The interest taken.* The Court below ruled that there here was a taking of a leasehold subject to a mortgage, but to do so it had to discard the following italicized language of the declaration: that the taking was subject *to the interest arising out of the* specified mortgage. The *interest* arising out of the Illinois mortgage is, of course, merely a lien [*Swanson* v. *United States*, 156 F. 2d 442 (9th Cir., 1946), cert. den. *sub. nom. Spokane Portland Cement Co.* v. *Swanson*, 329 U. S. 800], Illinois being a lien theory state (19A). We submit that the phrase must therefore have been used as a description of the ownership of the defendants under the laws of Illinois, indicating merely that the leasehold interest was subject to the lien of the mortgage, which would in no way whatsoever diminish the leasehold interest. If the government were to be substituting its ownership for that of petitioners by the taking, as

is the general rule,[20] then the phrase would have precisely such meaning. We contend that reference to the notice of condemnation shows that it has that meaning, the notice of condemnation purporting to condemn an estate in fee simple and so characterizing the interest.

B. *The ruling below that the government may condemn a non-existent interest in real estate and leave the condemnee liable for the mortgage debt without compensating him therefor, was a ruling in a way in conflict with applicable decisions of this Court.* This for several reasons.

First, as this Court has stated, "The constitutional provision [of eminent domain] is addressed to every sort of interest the citizen may possess." *United States* v. *General Motors Corp.*, 323 U. S. 373, 378. This is the first case in which a court has held that the Government may take an interest which the citizen may not possess. And the type of interest which a citizen may possess is determined by state, not federal, law.[21] No one in Illinois could possess the interest which the Court below ruled was taken.

Secondly, the Court below ruled that the definition of the interest taken is to be made entirely without reference to local law. This would seem to be in direct conflict with the following (*United States* v. *Powelson*, 319 U. S. 266, 279):

> "The right of the United States to exercise the power of eminent domain is 'complete in itself' and

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[20] "When the sovereign exercises the power of eminent domain, it substitutes itself in relation to the physical thing in question in place of him who formerly bore the relation to that thing, which we denominate ownership." *United States* v. *General Motors Corp.*, 323 U. S. 373, 378.

[21] The Court below held that "federal law * * * governs" (8A). But we know of no federal law of real property. Since if it existed it would be substantive law rather than procedural, it would not apply under the familiar principle of *Erie Railroad Co.* v. *Tompkins*, 304 U. S. 64.

> 'can neither be enlarged nor diminished by a State.' * * * *Though the meaning of 'property' as used in * * * the Fifth Amendment is a federal question, it will normally obtain its content by reference to local law.*" (Emphasis added.)

Thirdly, the vice of the decision below is that it takes the leasehold interest, and yet would have left the condemnee personally liable for the payment of the mortgage note. If the mortgagee had elected to sue the condemnee for the amount of the note, there would not be any way in which the condemnee could obtain freedom from liability, so far as we are aware. What the government did, then, was to divide the property into non-existent interests in order to avoid full payment of just compensation. But as this Court said in *United States* v. *General Motors Corp., supra*, 323 U. S. at 382:

> "It is altogether another matter when the government does not take his entire interest, but by the form of its proceeding chops it into bits, of which it takes only what it wants, however few or minute, and leaves him holding the remainder, which may then be altogether useless to him * * *. This is neither the 'taking' nor the 'just compensation' the Fifth Amendment contemplates."

In the case at bar, the government did not merely take a minute bit of the interest, leaving the condemnee holding the remainder, but left the condemnee holding a liability for a large sum.[22] Just compensation does not consist of subjecting the condemnee to an additional liability. "This is neither the 'taking' nor the 'just compensation' the Fifth Amendment contemplates". *Ibid.*

The reasoning of the Court below, reaching a contrary conclusion, raises other serious problems in federal con-

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[22] The balance of the outstanding mortgage indebtedness was over $6,000,000; the cash above the mortgages under the award was the sum of $954,000.

stitutional law. Thus, while it agrees that, under *Swanson v. United States, supra,* the extent of the title of one condemnee as opposed to another is determined by local law even when the dispute arises in the course of federal condemnation proceedings, it holds such is not the case when a "direct federal interest" is "involved". But a "direct federal interest" is "involved" in *every* federal condemnation case. This curious proposition announced below would necessarily result in the untenable paradox that the federal condemnation results in one set of rights in a dispute between mortgagor and mortgagee determined by "federal law" when the condemnor is a party, while state law yields another set of different rights between mortgagor and mortgagee when the condemnor is not a party. Confusion is compounded upon the taking, too, for the condemnor then is in the mortgagor's shoes (see p. 24, *supra*)—and which set of rights governs then?

We contended below that, as the District Court had held, state law should apply under that section of the Wherry Act, which provides that "(a) the term 'mortgage' means a first mortgage on real estate, in fee simple, or on a leasehold * * * and the term 'first mortgage' means such classes of first lien as are commonly given * * * under the laws of the State in which the real estate is located * * *." The Court below rejected our argument on the purported authority of *United States v. View Crest Garden Apts., Inc.*, 268 F. 2d 380 (9th Cir., 1959), where the Ninth Circuit held that federal law determines whether a receiver should be appointed. But *View Crest* clearly stated that it is *state definitions of mortgage liens which control, not federal law,* noting that a different set of factors came into play after the mortgage agreement was terminated where the only situation presented was one of remedies, where federal law applies.[23]

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[23] This of course is all that was held by this Court in *United States v. 93.970 Acres of Land*, 360 U. S. 328, so heavily relied on below.

The court below next relied on Congressional intent found from the Capehart Act reference to housing "acquired," in which case the Government may pay the mortgage. It held that "Since this is not limited to situations where there is a *purchase*, this would seem to imply an intent that the government can condemn a leasehold subject to a mortgage." (Emphasis the Court's.)[24] But the Court failed to note that subsection (c) provides that "condemnation proceedings instituted pursuant to this section shall be conducted in accordance with the provisions of section 257 of Title 40, or any other applicable federal statute." And it further ignored Section 801(d) of the Wherry Act (quoted *infra* at 27A), providing that the mortgagee may upon condemnation elect to receive the benefits of the mortgage insurance—which he of course could not do if the Government could assume the mortgage obligation.

We suggest that a more explicit Congressional intent would have to appear before the Congress could be held to have authorized the taking of a non-existent real estate interest, at variance with centuries of custom and practice.

It should also be noted that the condemnation in the case at bar was, among other statutes, pursuant to 40 U. S. C.

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[24] The court below did not note in this connection that, even if the Government *could* have paid the note upon the taking, it did not do so. It was many months after the taking before the Government secured a release of the mortgagor from the mortgagee (350a-51a). The Government then also purported to assume the liability on the mortgages, after petitioners had been liable on them for several months. Even assuming that it could assume the mortgage without the mortgagor's consent, the time hiatus shows that just compensation was lacking, for "the owner is entitled to reasonable, certain and adequate provision for obtaining compensation before his occupancy is disturbed." *Cherokee Nation* v. *Southern Kansas R. Co.*, 135 U. S. 641, 659. Here there was no certainty at all, at the time of the taking, that petitioners would be released from the mortgage obligations. Thus, no matter what the declaration purported to condemn, it was the entire leasehold interest that was taken. *Cf. United States* v. *Causby*, 328 U. S. 256.

§ 258a. But this section provides that "The Court shall have power to make such orders in respect of encumbrances, liens, * * * as shall be just and equitable.". Of course, the decision of the Court below renders nugatory the effect of 258(a), for if the Government may carve out an interest subject to a lien, the lien is not a part of the condemnation proceeding, and the Court would not have any power whatsoever to make an order in respect thereof discharging the lien—the very order the Government here sought. But if, on the other hand, there would still be some power in the Court to make an order in respect of liens, even without the lienor before it, its only power would be to make such orders "as shall be just and equitable"—and it seems clear that an order prescribing the taking of property, while leaving the condemnee liable on the mortgage, is not a just and equitable order.[25]

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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[25] As the Court below noted, the Government contends that the practical effect of acceptance of our argument would be an additional $148,000 to petitioners, which the Government terms a "windfall". However, had the Government initially deposited in Court a reasonable sum instead of its estimated condemnation award of $2.00 (2a), the problem discussed *supra* would never have arisen. If it be a "windfall", it is entirely of the Government's own making.

Appendix A

(Opinions of the United States Court of Appeals for the Seventh Circuit)

Before

HASTINGS, *Chief Judge*,

PARKINSON and CASTLE, *Circuit Judges*.

HASTINGS, *Chief Judge*.

This action was brought by the United States to condemn defendants' interests in two so-called "Wherry"[1] housing projects located on the Chanute Air Force Base at Rantoul, Illinois, subject to the interests of the mortgagees. The district court awarded $7,100,000 as just compensation. In No. 12497, defendants-appellants appeal from the sufficiency of the amount awarded, asserting errors in the measure of just compensation adopted, in the admission of certain valuation evidence and in conclusions of law. In No. 12498, the plaintiff-appellant appeals from rulings with respect to the interests being acquired, the law applicable to this federal eminent domain proceeding and from other conclusions of law by the district court, all directed, not to the valuation issue, but to the question whether the United States was empowered to condemn defendants' interests subject to outstanding mortgages.[2]

There were two housing projects built by Jonathan Woodner Company as sponsor and organizer of defendant corporations. Defendant Chanute Gardens Corpora-

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[1] "Wherry Act", 12 U. S. C. A. § 1748 et seq.

[2] The opinion of the district court is reported at 165 F. Supp. 474 and contains findings of fact, conclusions of law, various provisions of the pertinent leases and a resume of the evidence taken in this case. In the interest of brevity, these will not be set out in detail here and reference is made to Chief Judge Platt's opinion for such matter.

tion is the owner of Chanute Gardens (apartments for non-commissioned officers) and Chanute Apartments Corporation is the owner of Chanute Apartments (apartments for commissioned officers). It was stipulated that construction began on February 1, 1951 and was completed in March, 1953, at a cost to the builder of $8,297,969.23, exclusive of builder's and architect's fees, and trial by jury was waived.

The land on which the projects were erected (69 acres for Chanute Gardens and 27 acres for Chanute Apartments) was owned by the United States and leased by the Secretary of the Air Force to the defendant corporations for a period of 75 years at a nominal annual rental, "to be used for the purpose of erecting, maintaining and operating a housing project." Among other things, the leases provided that the premises be leased to personnel designated by the Air Force; set out the method of determining rental rates; required the lessees to pay any local taxes levied upon the leaseholds; prohibited any assignment without Air Force consent; specified that the buildings and improvements as erected and completed become "real estate and part of the leased lands, and public buildings of the United States;" and stated that "upon the expiration of this lease, or earlier termination, all improvements made upon the leased premises shall remain the property of the Government without compensation," except as to certain utility facilities.

The declaration of taking was filed May 1, 1957, and on that date each leasehold was encumbered by a mortgage owned by the New York State Employee's Retirement System and guaranteed by the Federal Housing Administration. There was also an outstanding loan made by the Air Force to the builder to enable it to complete the projects. It was stipulated that as of May 1, 1957, there was a total balance due on the mortgages of $6,145,694.31, and a balance due on the Air Force loan of $410,771.26, subject to any credits and offsets in favor of defendants.

The court viewed the premises and heard evidence introduced by both parties on the issue of just compensation. In addition there was a stipulation of certain uncontroverted facts. There was no evidence of comparable sales. After reviewing the evidence on the various factors found by the court to be relevant to just compensation (see the memorandum opinion referred to in footnote 1), the trial court found that the reasonable construction cost of the two projects was approximately $8,200,000, without builder's and architect's fees; and that the fair cash market value based on capitalization of rents was about $6,950,000. The court then finally found that "based upon the competent evidence and the view of the premises, that the defendants as owners of the leasehold interests are entitled to just compensation as of May 1, 1957, in the amount of $7,100,000," and judgment was entered accordingly, the award to include the amounts due on the mortgages and the Air Force loan and to bear interest at the rate of 6% as provided in the Declaration of Taking Act, 40 U.S.C.A. § 258a.

Defendants contend that the judgment should be reversed and a mandate issued directing judgment based on a proper finding of reproduction cost less depreciation in the sum of $9,150,000 as established by their evidence. The government makes no complaint as to the amount of the award of $7,100,000 insofar as the district court adopted fair market value as the measure of just compensation.

We have carefully considered the several rulings of the trial court with reference to the evidence and find no prejudicial error. We hold that there is more than ample competent evidence to support the award of $7,100,000. We are not required to guess or speculate on how the district court arrived at this final figure. Where there is no evidence of comparable sales it has been aptly said: "* * * assessment of market value involves the use of

assumptions, which make it unlikely that the appraisal will reflect true value with *nicety* * * * [and that this] involves, at best, a guess by informed persons." *United States* v. *Miller*, 317 U.S. 369, 374-375 (1943). (Emphasis added.)

It is well settled that in condemnation proceedings the award of just compensation "should be measured in various ways depending upon the circumstances of such case and that no general formula should be used for the purpose", the courts retaining the concept of market value as a practical standard. *United States* v. *Miller*, *supra*, at pages 373-374. Or, as it has been more concisely stated, it is "market value fairly determined." *Olson* v. *United States*, 292 U.S. 246, 255 (1934).

Defendants' contention that the district court should be confined to a consideration of reproduction cost less depreciation is not well taken in this case, and such method generally is held to be one of the least reliable indicia of market value. *United States* v. *49,375 Square Feet of Land, etc.*, D.C.S.D. N. Y., 92 F. Supp. 384, 388 (1950), affirmed *United States* v. *Tishman Realty & Const. Co.*, 2 Cir., 193 F. 2d 180 (1952), cert. denied, 343 U.S. 928. We are not satisfied that the property interest taken in this case is so unique as to take it outside the general rule. We have carefully examined defendants' many arguments to the contrary and the cases on which they seek to rely and do not find them to be controlling here.

Much has been written on the subject of "just compensation" and the cases are legion giving various expressions as to how it should be determined. In the final analysis, however, when the condemnee has been awarded just compensation based on market value fairly determined, having regard for the various factors dictated by the circumstances of each particular case, he may be said to have been made whole.

We hold that the district court, in its finding of just compensation in the amount of $7,100,000, did not err in

its interpretation of the evidence and its findings based thereon and that it applied the correct legal criteria in so doing. As to the appeal in No. 12497 the judgment is

AFFIRMED.

No. 12498

In its declaration of taking the government specifically condemned all right, title and interest of defendants in each of the leaseholds, subject to each mortgage. The district court held, in effect, that state law (Illinois) applies to the definition of the property interest the government can condemn; that *a leasehold interest subject to a mortgage* is not a recognized legal estate in Illinois, since in Illinois a mortgagee has only a lien and not a vested interest in the leasehold; and that the entire leasehold must be condemned, including the interest of the mortgagee, and the lien of the mortgagee to be transferred to the award. This holding is the subject of the counter-appeal by the United States in No. 12498, the government's contention being that federal and not state law controls.

The contested issue is whether the federal government can, under its power of eminent domain, and more specifically under its power to condemn military housing pursuant to 42 U.S.C.A. § 1594a, condemn a leasehold interest subject to a mortgage, a property interest unknown to the law of Illinois.

The practical effect of the holding of the district court is to grant to defendant 6% interest on the amount of the award for the period from May 1, 1957, the date of taking, to July 15, 1958, the date of payment of the judgment. This results, so the government contends, in a "windfall" to defendants of approximately $148,843.57, which is 2% interest for this period on the amount of the mortgages (the difference between the 4% interest payable under the

terms of the mortgages and the 6% interest payable under the Declaration of Taking Act).

The government sought to prevent this by filing a motion for an order declaring the judgment satisfied, in which motion it recited, *inter alia*, the facts concerning the mortgages and the balance due on the Air Force loan, deposits made by the government, and the government's position that defendants "have neither in law nor in fact any right to the amount representing the unpaid balance of the said mortgages nor any right to interest on the portion of the award equivalent to the unpaid balance on said mortgages." The government's motion was denied by the district court in its order entered on July 17, 1958.

The district court reasoned that its holding was dictated because Illinois is a lien theory state and state law governs, citing *Swanson* v. *United States*, 9 Cir., 156 F. 2d 442, 447 (1946), 170 A.L.R. 258, cert. denied, *Spokane Portland Cement Co.* v. *Swanson*, 329 U.S. 800, for the proposition that the mortgagee's rights are determined by state law. We think the district court's reliance on *Swanson* is misplaced. In that case, the dispute was between the mortgagor and the mortgagee as to their respective rights, and the court properly held that the extent of the title or right of one condemnee as opposed to another condemnee is determined by local law when such a dispute arises in the course of federal condemnation proceedings. No direct federal interest was involved. In the case before us here we have an entirely different question presented. There is no dispute here between defendants and the mortgagees, the latter not even being parties to this proceeding. The sole issue is whether the United States has the power to condemn only the interests of defendants and to exclude the rights of others not made parties.

The district court rejected the government's contention that it has legal authority to condemn the interest sub-

ject to the mortgage by virtue of 42 U.S.C.A. § 1594a. We agree that a literal reading of the statute does not reveal any such express authorization. Nor do we find any such specific authority in the original Housing Amendments of 1955, 69 Stat. 652, now codified into Section 1594a. However, it should be pointed out that nowhere in the statute under scrutiny does Congress expressly choose to make state laws applicable.

Defendants contend that state law should apply by citing Section 1707, 12 U.S.C.A., the original Wherry Act, which provides that "(a) The term 'mortgage' means a first mortgage on real estate, in fee simple, or on a leasehold * * * and the term 'first mortgage' means such classes of first liens as are commonly given * * * under the laws of the State in which the real estate is located * * *."

The argument that this section *per se* incorporates state law on all issues of law was rejected in *United States* v. *View Crest Garden Apts., Inc.*, 9 Cir., 268 F. 2d 380 (1959). In that case, there was a conflict as to whether state law or federal law applied with reference to the appointment of a receiver in an action to foreclose an FHA mortgage. In construing Section 1707 of 12 U.S.C.A., the Ninth Circuit found that it accepted and incorporated some of the incidences of state definition of mortgages, but that it was not Congressional intent to incorporate all state laws. The court held that federal law controls in such a situation and remanded the case for a determination as a matter of federal law whether the facts warranted the appointment of a receiver.

There is some indication of Congressional intent from the statute under which this action is brought. Subsections (e), (f) and (g) of 42 U.S.C.A. 1594a, refer to housing *acquired* under this section and provide that the government may thereupon rent the property, pay the mortgage, insurance and other charges and expenses. Since this is not limited to situations where there is a *purchase*,

this would seem to imply an intent that the government can condemn a leasehold subject to a mortgage. Such is the express holding of another district court in *United States* v. *Certain Interests in Property in Macomb County, Michigan, Selfridge Apartments, Inc., et al.*, Civil No. 17772, E.D. Mich. So. Div., (July 18, 1958).[3]

Finally, in our opinion, the Supreme Court of the United States in a recent opinion has made it abundantly clear that federal law rather than state law governs in federal eminent domain cases. *United States* v. *93,970 Acres of Land*, 360 U.S. 328 (1959). In that case, the government revoked a lease pursuant to the terms of the lease itself, but rather than litigate the question of its right to such revocation, in order to avoid delay, it also condemned whatever interest the lessee might retain. Under Illinois law, the owner of the leasehold claimed that the condemnation proceeding was an election of remedies and that thereby the government must abandon its revocation and that this was an implied recognition that certain property was retained by the lessee for which it would be entitled to just compensation. This circuit, in 258 F. 2d 17, 24 (1958), with one judge dissenting, did not pass upon the question of whether state or federal law applies in federal condemnation proceedings as to election of remedies, deciding that both federal and state law compelled such an election by the government in that case. The Supreme Court reversed, holding as a matter of federal law that there need be no election and that state law did not control. The language of Mr. Justice Black, 360 U.S. at page 332, is significant:

> "Respondents argue, however, that election of remedies is part of the law of Illinois and that Illi-

[3] The memorandum opinion of this district court does not appear to have been reported and is set out as an appendix to the government's reply brief.

nois law applies here. We cannot agree with this view. Condemnation involves essential governmental functions. See *Kohl* v. *United States*, 91 U.S. 367. We have often held that where essential interests of the Federal Government are concerned, federal law rules unless Congress chooses to make state laws applicable. It is apparent that no such choice has been made here." (Footnotes omitted.)

Condemnation being an essential governmental function and Congress not having chosen to make state law applicable to the definition of property interests condemned by the government, it follows that the United States is not limited to condemnation in terms known to the state, but rather may define such interests in terms of federal law.

We hold, therefore, that the United States can condemn a leasehold interest subject to an existing mortgage lien thereon, and that the district court erred in applying Illinois law to the contrary.

It is ordered that that part of the judgment of the district court entered in this action on June 25, 1958, which includes the amounts due on the mortgages and interest thereon, and the further order of the district court entered in this action on July 17, 1958, denying the motion of the United States for an order declaring the judgment satisfied, be reversed, and that this cause be remanded to the district for the entry of judgment and such further proceedings as may be necessary not inconsistent with this opinion. It is further ordered that, consistent with our holding in No. 12497, the valuation of defendants' interests as determined by the district court be not disturbed.

Appendix B

(Opinion of United States District Court, for the Eastern District of Illinois)

This is a condemnation suit duly instituted by the United States to take two housing projects erected under the provisions of the "Wherry Act", 12 U. S. C. A. § 1748 et seq., upon Chanute Air Force Base at Rantoul, Illinois. The declaration of taking was filed on May 1, 1957. One project, known as the Chanute Gardens, consists of apartments for non-commissioned officers and is owned by the defendant, Chanute Gardens Corporation. The other project, known as the Chanute Apartments, contains apartments for commissioned officers and is owned by the defendant, Chanute Apartments Corporation. Both projects were built by the Jonathan Woodner Company, who was the sponsor of the projects and the organizer of the defendant corporations. It was stipulated that the construction started on or about February 1, 1951, and that the projects were completed in March, 1953; that a jury would be waived and the cause submitted to the court to determine just compensation in the aggregate for the two projects; that the original cost to Jonathan Woodner Company was $8,297,969.23, exclusive of builder's and architect's fees, and that the court would view the premises. It was further stipulated that as of May 1, 1957 there was a need for an additional 450 units of military housing at Chanute Air Force Base.

The court has viewed the premises and examined the interior of two five-room apartments in each project and one six-room apartment in Chanute Apartments. The two projects are similar in outward appearance and construction. The Chanute Gardens consists of 13 storage and maintenance buildings and 102 buildings containing 378 five-room apartments, each with 819 square feet, and 224 six-room apartments containing 1050 square feet. The

Chanute Apartments consists of 5 separate storage and maintenance buildings and 37 buildings containing 120 five-room apartments each with 922 square feet, and 78 six-room apartments each containing 1050 square feet. Some of the storage and maintenance buildings have laundry facilities.

The construction is wood frame with brick veneer facing on the first floor front and street side, and asbestos shingles covering the composition sheeting on the wood frame elsewhere. The foundation is concrete block. The apartments are heated by a forced warm-air heating system, from a gas fired furnace in each unit located in an enclosed closet in the kitchen. Each unit has individual hot water heaters. The first floor is about two feet above the ground surface. The floors are plywood placed on 2" x 8" floor joists and covered with asphalt tile. There are sliding metal door closets in the bedrooms, and one guest closet with sliding door on the first floor. The windows are steel casement and sash. The walls are one-half inch dry wall finish with the seams taped. Each apartment has a bath with "tylac" lining around the bathtub. All of the apartments are painted, have front and rear entrances and inside doors on the bedrooms. The first floor in each apartment contains a living room, dining room and kitchen. The bedrooms are located on the second floor. Gable roofs are covered with asphalt shingles.

Land improvements include circular streets with asphalt surface and the necessary sewage, water, electric and gas connections.

The ground consisting of some 69 acres for the Chanute Gardens and 27 acres for the Chanute Apartments (the legal description appears in the leases), was leased by the Secretary of the Air Force to the corporation for a period of 75 years, at an annual rental of $100.00 for Chanute Gardens and $110.00 for Chanute Apartments, "to be used for the purpose of erecting, maintaining and operating a housing project".

The leases provided that the premises should be leased to military and civilian personnel designated by the Commanding Officer of the Chanute Air Force Base, provided that it might be leased to others after 30 days vacancy. The Commanding Officer was also given the privilege to replace non-military occupants.

Paragraph 4 of the leases provided:

> "That if at any time during the term of this lease there is no mortgage insured under the National Housing Act covering the interest of the Lessee and the leased premises are not under the control of the Commissioner, the rental rates for leases granted in accordance with Condition 3 shall be such rates as are agreed upon from time to time by the said Commanding Officer and the Lessee, provided, however, that, in case this lease shall be acquired by the Commissioner and subsequently assigned or sold, the rents shall not be reduced below the schedule of rents then in effect without the consent of the then owner and holder of the leasehold interest."

Paragraph 18 of the leases provided:

> "That except as otherwise specifically provided in this lease, all disputes concerning questions of fact or establishment of rental rates or standards of maintenance and repair after there is no mortgage held or insured by the Federal Housing Administration on the property and the leased premises are not under the control of the Commissioner, which may arise under this lease, and which are not disposed of by mutual agreement, shall be decided by the said Commanding Officer, who shall reduce his decision to writing and mail a copy thereof to the Lessee at its address shown herein. Within thirty (30) days from said mailing the Lessee may appeal

to the Secretary of the Air Force, whose written decision or that of his designated representative or representatives or board, shall be final and conclusive upon the parties hereto. Pending decision of a dispute hereunder, the Lessee shall proceed with the performance of this lease and in accordance with the Commanding Officer's decision. The provisions of this paragraph shall not be deemed to limit the provisions of Condition 4 of this lease with respect to rents."

The leases further provided that no assignment could be made without the Air Force consent, and that any local taxes levied upon the leaseholds would be paid by the lessees.[1] Also upon termination of the leases the buildings and improvements were to remain the property of the Government without compensation.

As of May 1, 1957, each leasehold was encumbered by a mortgage held by the New York State Employee's Retirement System, and guaranteed by the Federal Housing Administration. There was also outstanding a loan to the defendants from the Air Force to complete the projects. At the start of the trial it was stipulated that as of May 1, 1957, there was a total balance due on the mortgages of $6,145,694.31, and a balance due on the Air Force loan of

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[1] Such leaseholds are taxable. Offutt Housing Co. v. Sarpy County, 351 U. S. 253 (1956). But see P. L. 1020, § 511 (Aug. 7, 1956) in 42 U. S. C. A. § 1594 (note), and U. S. Code Congressional Service, Vol. 1, p. 1315, 84th Cong., 2d Sess. (1956).

Defendants offered in evidence without objection the decree of the Circuit Court of Champaign County, Illinois, dated May 22, 1957, in a suit by the defendants against the Board of Review of Champaign County, Illinois, et al. The decree fixed the amount of the taxes payable to the County of Champaign and its political subdivisions, for all assessments from the beginning of the "Wherry" projects to the date of the decree, and enjoined further assessment of taxes on the ground that the United States Government had paid large sums to local authorities which were found to be set-offs against future taxes under P. L. 1020, ibid.

$410,771.26, subject to any credits and offsets which the defendants might have.

The Government presented two real estate appraisers as witnesses. Mr. Walter Kuehnle, an experienced appraiser, testified that, in his opinion, the market value of the defendants' interest in the leasehold, which he termed their "equity", as of May 1, 1957, subject to the mortgages but not the Air Force loan, was $360,000.00, for the Gardens and $250,000.00 for the Apartments, for a total of $610,000.00. He defined market value as "what a willing purchaser not forced to buy will pay to a willing seller not forced to sell, both familiar with the property and the conditions." In reaching his conclusion Kuehnle studied, among other things, the community off the base to determine the economic rental potential, and the terms and restrictions of the mortgages and the Air Force leases. He determined that the maximum net rental income was limited to $321,515.00 for the Gardens and $119,370.00 for the Apartments. He based this upon his consideration of the FHA directives and the original project analyses compiled by the FHA which purported to limit the net rental return to 6½% of the original estimated construction cost. Kuehnle also considered the audits of rents and expenses for the years 1953 through 1956, raising and lowering various items which he thought justified according to his knowledge and experience in the management of such rental property. He noted an increase in monthly rentals for Chanute Gardens of $8.60 per apartment granted in June, 1954,[2] and a flat monthly charge of $8.40 per apartment in each project to cover the cost of cooking gas and electricity, which were not provided for in the original project analyses. Kuehnle believed this property to be investment property, and noted that the typical purchaser of such real estate resorts to financing. Finding that the cost of the

[2] There was evidence that defendants had made several other requests for rental increases, which were not allowed.

mortgages guaranteed by the Federal Housing Administration was 4% plus ½% required for the payment of mortgage insurance; he testified that, in his opinion, these mortgages were quite favorable, considering prevailing mortgage interest rates as of May 1, 1957, and that if the properties were free and clear of these mortgages the value of the premises would be less. Kuehnle valued the projects according to capitalization of prospective income and replacement value. His opinion was that reproduction cost less depreciation of $633,558.00 amounted to $8,733,561.00 on May 1, 1957. He estimated the remaining useful life of the projects at 37 years. Kuehnle rejected net replacement cost as representing the fair cash market value for the reason that the income produced was not sufficient to justify it. He determined that prospective net income, after payment of mortgage principal and insurance but before depreciation allowance, would amount to $55,164.00 for Chanute Gardens and $35,199.00 for Chanute Apartments. In capitalizing this income, Kuehnle estimated that a willing purchaser would require a 15.4% yield on Chanute Gardens and a 14.3% yield on Chanute Apartments, and therefore multiplied the prospective income of the Gardens by 6.5 and of the Apartments by 7.4 to arrive at market value. Kuehnle referred to the sale of an apartment building in St. Louis, Missouri, in July, 1957, and to the sale of a housing project at Fort Devins, Massachusetts, on March 31, 1956, which attracted investments at yields of 14.3% and 16.1% respectively. Both of these projects were constructed under the National Housing Act.

The evidence disclosed that the defendants defaulted in their repayment of the Air Force loan and the Air Force took over the management of the projects on May 28, 1954. It was determined that a large savings in expense could be attained by the purchase of the distribution system for electricity, and the defendants attempted to induce the Air Force to allow the purchase of a distribution system. Purchase contracts were concluded but the purchase was never

consummated. In determining the net prospective rentals Kuehnle took into consideration the savings which would have resulted from the purchase, and added $32,000.00 a year to the net rentals.

Mr. Dominick Dunn, the second real estate appraiser, testified that it was his opinion that the value of the defendants' interest in the leaseholds, subject to the mortgages but not the Air Force loan, amounted to $527,858.00 as of May 1, 1957. This valuation was determined by capitalizing prospective net income, after payment of mortgage, principal, interest and insurance. Dunn estimated prospective rents from the audits of the corporations and the prevailing non-military rents in the community. He also considered the terms and restrictions in the mortgages and leases, and the inherent risk of investment in property of this nature. Dunn concluded that a purchaser would strive to recoup his investment in 15 years and would demand a 12% return on his investment. Dunn estimated replacement cost, less depreciation, at $8,251,385.00, but rejected this as determinative of market value. In his opinion depreciation amounted to approximately $916,800.00 on May 1, 1957, with the projects having a remaining useful life of 35 years.

Mr. Allen C. Gardner, a mortgage analyst, testified for the Government, and though he was not familiar with the premises here involved he estimated that a purchaser of the leaseholds subject to the mortgages might be satisfied with a return as low as 11% on his investment. Most of his testimony was incompetent and immaterial.

The defendants offered the testimony of Mr. Stanley Roe, a real estate appraiser. Roe concluded that the market value between a willing seller and a willing purchaser of the defendants' leasehold interests as of May 1, 1957 was, in his opinion, $8,743,914.00 free and clear of encumbrances. This valuation was attained by capitalization of prospective net income, the same method used by the Government witnesses. In determining prospective rent he included

certain income from laundry facilities which were not being condemned. Therefore, the above valuation should be reduced by approximately $38,000.00. Roe disregarded the mortgage instruments and did not deduct the payment of mortgage principal and interest from his capitalized rental income. To reach capitalized value he used a multiplier of 14.5354 which would provide a return of 6½% upon the investment and also return the investment after 46 years. Roe compared the rents on the base with those off the base but determined prospective income on the basis of free and fair rents without consideration of the terms of the leases or the actual rentals charged. He first stated that he would change the valuation of the premises if he assumed that the rents were controlled, but later said that in his valuation he assumed that the Government officials would be reasonable and thus would grant reasonable rental increases. It was his opinion that the FHA mortgages, with their low interest rates, would not enhance the value of the leaseholds. Roe fixed the replacement cost less depreciation, as of May 1, 1957, at $9,150,000.00. His estimate of depreciation was $350,000.00 and that of the remaining useful life of the premises was 46 years.

The defendants also presented Mr. George Duso, a cost estimator, as an expert witness to determine the replacement cost of the leaseholds as of May 1, 1957. He concluded that the replacement cost, excluding builder's and architect's fees, of Chanute Gardens was $6,722,868.00, and $7,551,125.00 including the fees. The replacement cost, as of the same date, of Chanute Apartments was estimated at $2,345,138.00, without the builder's and architect's fees, and $2,634,058.00 including such fees. Upon cross-examination Duso said that bids submitted by contractors on a ten million dollar project would range up or down from his estimate by some 5% to 20%.

Mr. Robert A. Nathan, a consulting economist from Washington, D. C., testified for the defendants that, based upon the study of construction cost trends, it was his opin-

ion that construction cost increased 14.2% from 1951 to May, 1957. He noted that the original net rentals when the projects were first planned between the Government and the defendants were limited to 6½% of costs estimated as of 1950. In his judgment a 1957 capitalization of rents, which rentals were based upon 1950 estimated construction cost, would not fairly reflect the fair cash market value as of May 1, 1957, due to the sharp rise in cost of building starting with the Korean War.

Mr. Russell Law testified for the defendants that he was bookkeeper for Jonathan Woodner Company during the construction of the projects. He verified the amounts spent for materials and labor, and stated that he managed the projects for said Company until May 28, 1954. Subsequently Law continued as manager of the projects but took his orders from the Air Force and was paid by the defendant corporations.

Mr. Nathan B. Filbey testified for the defendants as to the correctness of the financial statements of the two corporations offered by the Government starting in 1953 when the projects were completed through 1956.

This is a brief summary of the evidence. From all the competent evidence and its view of the premises the court must determine what would be just compensation for the two projects.

The Government contends that the compensation awarded should be for the interest of the defendants subject to the amount due on the notes secured by the mortgages. The complaint alleges that the interest condemned is all right, title and interest of the defendants in the leaseholds, subject to each mortgage. The *extent* and *kind* of estate to be acquired is to be determined by Congress. United States v. Kansas City, Kan., 10 Cir., 1946, 159 F. 2d 125. The mortgagee's rights are determined according to state law. Swanson v. United States, 9 Cir., 1946, 156 F. 2d 442, 447, cert. denied 329 U. S. 800. Since in Illinois the mortgagee has only a lien and not a vested

interest in the leaseholds, the Government will be vested with the entire title to the leaseholds and the mortgagee's lien is transferred to the award. City of Chicago v. Salinger, 1944, 384 Ill. 515. The same rule is applicable in other lien states. United States v. Certain Lands in Borough of Brooklyn, 129 F. 2d 577; United States v. 53¼ Acres of Land, More or Less, etc., 139 F. 2d 244; Swanson v. United States, supra. The mortgagee has a lien but no title in the leasehold. The Government could have carved out a lesser estate, such as an easement, or leasehold for only ten years, but clearly the Government is taking all of defendants' title or interest in the leaseholds. An interest *subject to a mortgage* is not a recognized legal estate in Illinois.

The Government insists that it has legal authority to condemn the interest subject to the mortgage by virtue of 42 U. S. C. A. § 1594a. Section 1594a(c) specifically refers to condemnation proceedings and states:

> "Condemnation proceedings instituted pursuant to this section shall be conducted in accordance with the provisions of Section 257 of Title 40, or any other applicable Federal statute."

There is no reference to condemnation subject to a mortgage in any other subsection of 1594a nor is there any applicable statute which the Government has cited which authorizes directly or indirectly condemnation of the entire estate subject to a mortgage.

The mortgage indebtedness will be considered when the award is distributed. The mortgagee has been given notice of the taking of the interest of the defendants but it must be noted that in the notice no mention is made of taking subject to the mortgages. The Government insists that it may assume the mortgage indebtedness. The assumption of the indebtedness is not before the court at this time nor is there any evidence of such assumption. Upon distribution

the Government may obviously assume the mortgages, if agreeable to the mortgagee. In such case the mortgagor is entitled to be relieved of his liability and will be so relieved by the transfer of the mortgage lien to the award. Therefore, the words "subject to the mortgage" are not applicable to the interest condemned. They do advise the court of outstanding mortgages to be considered when the distribution is made. At this time these words must be omitted as surplusage.

The Government contends that only the capitalization of rents should be considered in the valuation of the defendants' interest. The Government is inconsistent in this contention since it offered evidence of reproduction cost. Moreover, the Government objected to original cost, but such cost was less than reproduction cost. There was no evidence of comparable sales. The witness Kuehnle only referred to certain sales to obtain information as to what percentage of return a purchaser might require on his investment. In the absence of comparable sales evidence of the original cost and the reproduction cost as well as the capitalization of rental income is competent in the determination of what is just compensation. See e.g., Clark v. United States, 8 Cir., 1946, 155 F. 2d 157. Capitalization of rents need not be solely adopted. Demetria Sifuentes v. United States, 1 Cir., 1948, 168 F. 2d 264, 266. The just compensation should not be determined by selecting any one formula of valuation and pursuing that to the very end. This would inevitably give a wrong result. See United States v. 49,375 Square Feet of Land, Etc., D. C. S. D. N. Y., 1950, 92 F. Supp. 384, 387, aff'd 193 F. 2d 180, cert. denied 343 U. S. 928. All the elements which go to make up fair cash market value should be considered since such value can only be an informed guess. United States v. Miller, 317 U. S. 369, 374-375. The court, therefore, will discuss these factors which are relevant to just compensation.

Original Cost

It was stipulated that the cost to Jonathan Woodner Company of the propects, exclusive of builder's and architect's fees, was $8,297,969.23. The projects were completed in March, 1953. The witness Law testified that there was a stoppage in the work due to lack of financing and he estimated that the stoppage increased the cost about $18,000.00. He testified that supplies and materials were purchased and subcontracts were let on a competitive bid basis. There was evidence that a standard builder's fee was 8% and architect's fee was 4% after the builder's fee is added. The witness Nathan estimated the original cost at about $8,000,000.00, exclusive of builder's and architect's fees. This estimate was reached by assuming a construction cost of $9,068,000.00, exclusive of builder's and architect's fees, on May 1, 1957, as testified to by the witness Duso. Nathan projected back to the date of actual construction. The court finds that the reasonable cost of the two projects was approximately $8,200,000.00, without builder's and architect's fees.

Reproduction Cost

The testimony varied on the estimated reproduction cost as of May 1, 1957, including builder's and architect's fees, from $9,168,206.00 to $10,185,193.00. The top estimate was given by Duso as an estimate upon which contractors bid to obtain a contract for the construction of a project. He further testified that a bid submitted by a contractor on such projects as here involved would vary 5% to 20% from his estimate. There was evidence that the reproduction cost as of May 1, 1957 would be greater than the original cost. The court finds from all the competent evidence that the reproduction cost, as of May 1, 1957, would be about $9,500,000.00. In the replacement cost the builder's and architect's fees should be and are included.

Depreciation

As of May 1, 1957, the buildings were about four years old. All the evidence is to the effect that the property had depreciated. The amount of depreciation varied from Roe's estimate of $350,000.00 to Dunn's estimate of $916,000.00. The estimated remaining useful life of the buildings varied from 35 to 46 years. Naturally this would affect the amount of the depreciation. Roe confined his estimated depreciation to what he observed. Obviously this would not be an accurate estimate because there are many elements in the physical structure which could not be seen. The court finds that the fair depreciation for the four year period would be approximately $750,000.00 leaving a net replacement cost of around $8,750,000.00 as of May 1, 1957.

Capitalization of Rental Income

The court finds from all the competent evidence that the fair cash market value with a buyer willing to buy and a seller willing to sell varies from Dunn's estimate of $6,673,552.31 to Roe's estimate of $8,685,914.00. Kuehnle fixes a fair cash market value of $6,755,694.31. The court in arriving at these figures has added the mortgage indebtedness to the values estimated by Dunn and Kuehnle for the defendants' "equity". The court has deducted from Roe's estimate of market value $58,000.00 which he improperly included for laundry facilities.

The defendants complained that the valuation of their interests subject to the mortgages was unfavorable and improper. Both Dunn and Kuehnle considered that the mortgages at their low interest rate were advantageous to the defendants. The result, therefore, does not harm the defendants whether their interest is valued subject to the mortgages and the mortgages added, or the entire interest is valued free and clear of the mortgage indebtedness.

The valuations of Dunn and Kuehnle gave no credit for payment of the mortgage principal. They subtracted the payments on the principal from net rental income and capitalized the resulting amount. Amortization of mortgage indebtedness is not an expense item, and to treat it as such would improperly reduce the valuation. See De-Luz Homes v. County of San Diego, 290 P. 2d 544 (Calif., 1955). Also, Dunn on cross-examination stated he gave no consideration to the existence of a hypothetical willing seller, stating that the capitalization method of determining market value only requires the existence of a willing purchaser.

On the other hand, Roe in reaching his estimated fair cash market value based estimated gross rentals largely on the higher rents charged for housing off the base and did not give sufficient weight to the provisions of the leases requiring Air Force consent for rental increases. He testified that his gross rentals were reasonable. However, he only considered reasonableness from the standpoint of the two corporations and not from the standpoint of a major purpose of these projects, namely, to provide reasonable rentals to Air Force personnel. At one point in his testimony he said that he would reduce his estimated value if, in fact, the terms of the lease did control the rentals. In giving controlling importance to off-base rentals, Roe gave inadequate consideration to the fact that off-base housing would likely be constructed on land owned in fee which would have required an additional investment and would have been subject to all local taxes.

The capitalization of net rents to determine value would vary materially according to the multiplier to be used upon the determined net rentals. The applicable multiplier varied from Roe's 14.5354 to Dunn's 6.8. The court taking into consideration an estimated net rental and multiplier which would satisfy both a willing buyer and a willing seller finds that based upon the capitalization of rent the value of the premises is about $6,950,000.00.

The defendants offered no evidence to prove that any value inhered to the remaining term of the 75 year leaseholds after the termination of the useful life of the buildings. The defendants would be liable for payment of ground rental, but under the terms of the lease it is doubtful that the buildings would be reproduced.

The court therefore finds, based upon the competent evidence and the view of the premises, that the defendants as owners of the leasehold interests are entitled to just compensation as of May 1, 1957, in the amount of $7,100,000.00. On distribution the amount due on the indebtedness secured by the mortgages and the Air Force loan must be deducted in accordance with the stipulated amounts due.

The Government and the defendants have submitted suggested findings of fact. The court in this opinion has made sufficient findings of fact and conclusions of law and these may stand in lieu of separate findings. Those findings of fact requested which are not included are deemed unnecessary as ultimate findings of fact.

Order may be submitted in accordance herewith.

Dated this 12th day of May, 1958.

CASPER PLATT
United States District Judge

Appendix C

THE WHERRY ACT 63 STAT. 570

"TITLE VIII—MILITARY HOUSING INSURANCE

"SEC. 801. As used in this title—

"(a) The term 'mortgage' means a first mortgage on real estate, in fee simple, or on a leasehold (1) under a lease for not less than ninety-nine years which is renewable; or (2) under a lease for a period of not less than fifty years to run from the date the mortgage was executed; and the term 'first mortgage' means such classes of first liens as are commonly given to secure such advances on, or the unpaid purchase price of, real estate, under the laws of the State in which the real estate is located, together with the credit instruments, if any, secured thereby.

• • •

"(b) To be eligible for insurance under this title a mortgage shall meet the following conditions:

"(1) The mortgaged property shall be held by a mortgagor approved by the Commissioner. The Commissioner may, in his discretion, require such mortgagor to be regulated or restricted as to rents or sales, charges, capital structure, rate of return, and methods of operation. The Commissioner may make such contracts with, and acquire for not to exceed $100 stock or interest in, any such mortgagor, as the Commissioner may deem necessary to render effective such restriction or regulation. Such stock or interest shall be paid for out of the Military Housing Insurance Fund, and shall be redeemed by the mortgagor at par upon the termination of all obligations of the Commissioner under the insurance.

"(2) The mortgaged property shall be designed for rent for residential use by civilian or military personnel of the Army, Navy, Marine Corps, or Air Force (including Government contractors' employees) assigned to duty at

the military installation at or in the area of which such property is constructed. Notwithstanding the provisions of any other law, preference or priority of opportunity in the occupancy of the mortgaged property for such personnel and their immediate families shall be provided under such regulations and procedures as may be prescribed by the Commissioner. No mortgage shall be insured under this title unless the Secretary of Defense or his designee shall have certified to the Commissioner that the housing with respect to which the mortgage is made is necessary to provide adequate housing for such personnel, that such installation is deemed to be a permanent part of the Military Establishment, and that there is no present intention to substantially curtail activities at such installation.

"(3) The mortgage shall involve a principal obligation in an amount—

"(A) not to exceed $5,000,000; and

"(B) not to exceed 90 per centum of the amount which the Commissioner estimates will be the replacement cost of the property or project when the proposed improvements are completed; and

"(C) not to exceed an average of $8,100 per family unit for such part of such property or project as may be attributable to dwelling use, except that where the Secretary of Defense or his designee in exceptional cases certifies and the Commissioner concurs in such certification that the needs would be better served by single-family detached dwelling units the mortgage may involve a principal obligation not to exceed $9,000 per family unit for such part of such property as may be attributable to such dwelling units.

"The mortgage shall provide for complete amortization by periodic payment within such terms as the Commissioner shall prescribe, and shall bear interest (exclusive of pre-

mium charges for insurance) at not to exceed 4 per centum per annum of the amount of the principal obligation outstanding at any time. * * * ''

''(d) * * * If, during the time the mortgage is insured and before the mortgagee has received the benefits of the insurance, the United States acquires, or commences eminent domain proceedings to acquire, all or a substantial part (as defined by the Commissioner) of the mortgaged property for the use of the National Military Establishment, the mortgagee may, at its election, within such time and in accordance with such regulations as the Commissioner may prescribe, receive the benefits of the insurance as provided in this subsection, notwithstanding the fact that the mortgage may not be in default.

* * *

''SEC. 808. The Commissioner is authorized and directed to make such rules and regulations as may be necessary to carry out the provisions of this title:''

* * *

THE 1955 CAPEHART ACT (69 Stat. 646)

''Sec. 401, Title VIII of the National Housing Act, as amended, is hereby amended to read as follows:

''SEC. 803—

''(b) * * *

''(3) The mortgage shall involve a principal obligation in an amount— * * *

''(B) not to exceed an average of $13,500 per family unit for such part of such property or project as may be attributable to dwelling uses; *Provided*, That the replacement cost of the property or project as determined by the Commissioner including the estimated value of any usable utilities within the boundaries of the property or project where owned by the United States and not provided for out of the proceeds of the mortgage, shall not exceed an average of $13,500 per family unit; and * * *''

"SEC. 404. Whenever the Secretary of Defense or his designee shall deem it necessary for the purposes of this title, he may acquire by purchase, donation, or other means of transfer, or may cause proceedings to be instituted in any court having jurisdiction of such proceedings to acquire by condemnation, any unimproved land, or (with the approval of the Federal Housing Commissioner) any housing financed with mortgages insured under the provisions of title VIII of the National Housing Act as in effect prior to the enactment of the Housing Amendments of 1955. Notwithstanding the provisions of any other law, the price paid for any such unimproved land or housing purchased by the Secretary under this or any other law shall be the fair market value of such land or housing as determined by the Secretary on the basis of an independent appraisal, and, in connection with any agreements to purchase such housing, the Secretary of Defense or his designee may assume, or purchase subject to, any such mortgage. * * *.

The 1956 CAPEHART ACT (70 Stat. 1091)*.

* This is referred to in the opinion of the Court of Appeals (7A, 8A) as 42 U. S. C. A. § 1594a.

"SEC. 505. Section 803(b)(3)(B) of such Act is amended to read as follows:

"(B) not to exceed an average of $16,500 per family unit for such part of such property or project (including ranges, refrigerators, shades, screens, and fixtures), as may be attributable to dwelling use; Provided, That the replacement cost of the property or project is determined by the Commissioner, including the estimated value of any usable utilities within the boundaries of the property or project where owned by the United States and not provided for out of the proceeds of the mortgage, shall not exceed an average of $16,500 per family unit, and."

SEC. 512. Section 404 of the Housing Amendments of 1955 is amended to read as follows:

"SEC. 404. (a) Whenever the Secretary of Defense or his designee deems it necessary for the purpose of this title, he may acquire by purchase, donation, condemnation, or other means of transfer, any land or (with the approval of the Federal Housing Commissioner) any housing financed with mortgages insured under the provisions of title VIII of the National Housing Act as in effect prior to the enactment of the Housing Amendments of 1955. The purchase price of any such housing shall not exceed the Federal Housing Commissioner's estimate of the replacement cost of such housing and related property (not including the value of any improvements installed or constructed with appropriated funds) as of the date of final endorsement for mortgage insurance reduced by an appropriate allowance for physical depreciation, as determined by the Secretary of Defense or his designee upon the advice of the Commissioner: Provided, That in any case where the Secretary or his designee acquires a project held by the Commissioner, the price paid shall not exceed the face value of the debentures (plus accrued interest thereon) which the Commissioner issued in acquiring such project.

"(b) Notwithstanding any provision of subsection (a) to the contrary, the Secretary of Defense or his designee shall, in the manner provided in subsection (a), acquire by purchase, donation, or other means of transfer or, if the parties cannot agree upon terms for acquisition by such means by condemnation, any housing constructed under the mortgage insurance provisions of title VIII of the National Housing Act (as in effect prior to the enactment of the Housing Amendments of 1955) which is located at or near a military installation where the construction of housing under the Armed Services Housing Mortgage Insurance Program has been approved by the Secretary.

"(c) Condemnation proceedings instituted pursuant to this section shall be conducted in accordance with the provisions of the Act of August 1, 1888 (25 Stat. 357; 40 U. S. C., sec. 257) as amended, or any other applicable Federal statute. Before any such condemnation proceedings are instituted, an effort shall be made to acquire the property involved by negotiation. In any condemnation proceedings instituted pursuant to this section, the court shall not order the party in possession to surrender possession in advance of final judgment unless a declaration of taking has been filed, and a deposit of the amount estimated to be just compensation has been made, under the first section of the Act of February 26, 1931 (46 Stat. 1421), providing for such declarations. Unless title is in dispute, the court, upon application, shall promptly pay to the owner at least 75 per centum of the amount so deposited, but such payment shall be made without prejudice to any party to the proceeding. In the event that condemnation proceedings are instituted in accordance with procedures under such Act of February 26, 1931, the court shall order that the amount deposited shall be paid in a lump sum or over a period not exceeding five years in accordance with stipulations executed by the parties in the proceedings. In connection with condemnation proceedings which do not utilize the procedures under such Act, the Secretary or his designee, after final judgment of the court, may pay or agree to pay in a lump sum or, in accordance with stipulations executed by the parties to the proceedings, over a period not exceedings five years the difference between the outstanding principal obligation, plus accrued interest, and the price for the property fixed by the court. Unless such payment is made in a lump sum, the unpaid balance thereof shall bear interest at the rate of 4 per centum per annum.

"(d) Property acquired under this section may be occupied, used, and improved for the purposes of this section prior to the approval of title by the Attorney General as required by section 355 of the Revised Statutes, as amended.

"(e) The Secretary or his designee may, in the case of any housing acquired or to be acquired under this section, make arrangements with the mortgagee whereby such mortgagee will agree to release and waive all requirements of accruals for reserves for replacement, taxes, and hazard insurance provided for under the corporate charter and indenture agreement with respect to such housing, upon the execution of a written agreement by the Secretary or his designee that the purposes for which such reserves and other funds were accrued will be carried out.

"(f) Any housing acquired under this section may be (1) assigned as public quarters to military personnel and their dependents; or (2) leased to military and civilian personnel for occupancy by them and their dependents, upon such terms and conditions as will in the judgment of the Secretary of Defense or his designee be in the best interest of the United States, without loss to military personnel of their basic allowance for quarters or appropriate allotments. Amounts equal to the quarters allowances or appropriate allotments of military personnel to whom such housing is assigned as public quarters under clause (1), and the rental charges realized under clause (2), shall be deposited in the revolving fund created by subsection (g).

"(g) There is hereby created a fund which shall be used by the Secretary of Defense or his designee as a revolving fund for the purpose of paying for housing and related property acquired under this section, paying interest, principal, mortgage insurance premiums, and other obligations (except those for maintenance and operation) with respect to such housing, and paying expenses incurred in the alteration, improvement, rehabilitation, and repair of such housing. The amounts and charges referred to in the last sentence of subsection (f) of this section, and any savings realized in the operation of section 405, shall be deposited in such fund. For the purposes of the preceding sentence, the term 'savings realized in the operation of section 405' means the difference between the amount made available for payments under section 405 and the amount actually used in making such payments.

"(h) The Secretary of the Treasury is authorized and directed to establish on the books of the Treasury Department the revolving fund created pursuant to the authority of this section. To provide capital for such fund, there is authorized to be appropriated a sum not to exceed $50,000,000 and the Secretary of Defense, with the approval of the President, is authorized to transfer from unexpended balances of any appropriations of the military departments not carried to the surplus fund of the Treasury such sums as may be determined by the Secretary of Defense to be necessary to provide adequate capital for the revolving fund."

56 STAT. 303 (SECTION 608 OF THE NATIONAL HOUSING ACT)

SEC. 11. Title VI of the National Housing Act, as amended, is hereby further amended by adding the following new section at the end thereof:

"SEC. 608. (a) In addition to mortgages insured under section 603 of this title, the Administrator is authorized to insure mortgages as defined in section 601 of this title (including advances on such mortgages during construction) which are eligible for insurance as hereinafter provided.

"(b) To be eligible for insurance under this section a mortgage shall meet the following conditions:

"(1) The mortgaged property shall be held by a mortgagor approved by the Administrator. The Administrator may, in his discretion, require such mortgagor to be regulated or restricted as to rents or sales, charges, capital structure, rate of return, and methods of operation. * * *

40 U. S. C. § 258a

"* * * The court shall have power to make such orders in respect of encumbrances, liens, rents, taxes, assessments, insurance, and other charges, if any, as shall be just and equitable."

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No. 808

In the Supreme Court of the United States

OCTOBER TERM, 1959

CERTAIN INTERESTS IN PROPERTY IN CHAMPAIGN COUNTY, STATE OF ILLINOIS; CHANUTE GARDENS CORPORATION AND CHANUTE APARTMENTS CORPORATION, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals (Pet. App. 1A-9A) is reported at 271 F.2d 379. The opinion of the District Court (Pet. App. 10A-24A) is reported at 165 F.Supp. 474.

JURISDICTION

The judgment of the Court of Appeals was entered on October 21, 1959. A timely motion for rehearing by the petitioners was denied on November 24, 1959. On January 29, 1960, Mr. Justice Clark granted an

order extending the time within which to petition for a writ of certiorari to March 22, 1960, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether this federal eminent domain proceeding is governed by federal law, rather than by state law.

2. Whether the measure of just compensation should be based upon the fair market value of the interests condemned rather than upon the reproduction cost of the federally-owned buildings involved.

STATEMENT

This action was brought by the United States to condemn the petitioners' leasehold interests, subject to the interests of the mortgagee, in two housing projects which were constructed under the terms of the so-called Wherry Act (Act of August 8, 1949, 63 Stat. 570, 12 U.S.C. 1748 *et seq.*). The projects were located on the Chanute Air Force Base at Rantoul, Illinois.

Both projects were built by the Jonathan Woodner Company as sponsor and organizer of petitioner corporations. The declaration of taking was filed on May 1, 1957. As of that date, each leasehold was encumbered by a mortgage owned by the New York State Employee's Retirement System and guaranteed by the Federal Housing Administration. There was also an outstanding loan made by the Air Force to the builder to enable it to complete the projects. It was stipulated that as of the date of taking there was a total balance due on the mortgages of $6,145,694.31, and a balance due on the Air Force loan of $410,771.26, subject to any credits

and offsets in favor of the petitioners. It was also stipulated that construction, completed in 1953, cost $8,297,969.23, exclusive of builder's and architect's fees.

Trial by jury was waived. Both parties offered considerable valuation testimony and the premises were viewed by the court. As indicated in the opinion of the District Court, its award of $7,100,000.00 (from which the indebtedness secured by the mortgages and the Air Force loan was to be deducted on distribution) was within the range of the evidence (Pet. App. 22A, 24A):

> The court finds from all the competent evidence that the fair cash market value with a buyer willing to buy and a seller willing to sell varies from Dunn's estimate of $6,673,552.31 to Roe's estimate of $8,685,914.00. Kuehnle fixes a cash market value of $6,755,694.31. The court in arriving at these figures has added the mortgage indebtedness to the values estimated by Dunn and Kuehnle for the defendants' [petitioners'] "equity". The court has deducted from Roe's estimate of market value $58,000.00 which he improperly included for laundry facilities.

The trial court also ruled that the United States could not condemn the leasehold interests subject to the mortgages, reasoning that a leasehold interest subject to a mortgage is not a recognized legal estate under the law of Illinois (Pet. App. 18A-19A). Accordingly, the court concluded that the mortgage indebtedness was not to be considered in arriving at the valuation of the property, but taken into account only in making distribution (Pet. App. 18A-20A). A

judgment was thereafter entered in favor of the petitioners in the amount of $7,100,000.00, "which said sum includes the amounts due on the mortgages and the Air Force loan, said sum of $7,100,000.00 to bear interest as provided by the Declaration of Taking Act (40 U.S.C.A. 258a-e)" (Def. App. 349a).[1]

Petitioners filed notices of appeal "confined to the inadequacy of the total sum of $7,100,000.00 adjudged to be just compensation" (Def. App. 363a, 365a). The United States made no challenge to the overall valuation but cross-appealed from the determination that "the United States was [not] empowered to condemn defendants' [petitioners'] interests subject to outstanding mortgages" (Pet. App. 1A)—an issue which bears on the amount of interest due petitioners.

With respect to petitioners' appeal, which challenged the adequacy of the award, the Court of Appeals affirmed the judgment of the District Court, holding that there was "more than ample competent evidence to support the award of $7,100,000" (Pet. App. 3A). On the government's appeal, the Court of Appeals reversed, holding that "the United States can condemn a leasehold interest subject to an existing mortgage lien thereon, and that the district court erred in applying Illinois law to the contrary" (Pet. App. 9A). As the opinion below points out (Pet. App. 5A-6A), that ruling prevented a windfall to defendants of $148,843.57—one which resulted under the

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[1] "Def. App." references are to the "Appendix for Defendants-Appellants-Appellees" filed in the Court of Appeals. References to the "Appendix for Plaintiff-Appellee-Appellant" will be shown as "Pl. App.".

District Court's judgment because of the difference between the interest rate on the mortgages and that provided in the Declaration of Taking Act.[2]

ARGUMENT

1. This Court has recently observed that the exercise of the condemnation power in federal eminent domain cases is governed by federal law. *United States* v. *93.970 Acres of Land,* 360 U.S. 328. The Court has also made clear that the eminent domain power of the sovereign "is addressed to every sort of interest the citizen may possess." *United States* v. *General Motors Corp.,* 323 U.S. 373, 378. Thus, the court below correctly ruled that there is no obstacle to a taking of the Wherry sponsors' interest subject to the mortgage. As the Court of Appeals also indicated (Pet. App. 7A-8A), there is evidence that Congress contemplated use of this procedure.

Petitioners suggest that under the government's theory they might be left "liable for payment" on the mortgages (Pet. 31, 32, 33). There is hardly room for any such objection. By instrument dated April 14, 1958, filed July 15, 1958, the mortgagee expressly released petitioners "from any and all liability for payment of the mortgage notes and indebtedness secured by the aforesaid mortgages" (Pl. App. 91).[3]

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[2] The mortgage holders are only entitled to 4% interest to the date of payment, whereas the District Court's judgment required the United States to pay 6% interest on the amount of mortgage balances from the date of taking.

[3] The United States, acting through the Department of the Air Force, has assumed and agreed to pay the mortgage indebtedness under tri-party agreements (one of which is printed at Def. App. 354a-359a), entered into between the Department of the Air Force,

2. The remaining contentions of petitioners relate to their claim that the valuation was too low.[4] The relevant considerations are largely factual and we believe that there is no occasion to depart from the ordinary two-court rule. Although petitioners argue that reproduction cost less depreciation should measure just compensation, their witnesses took no such position at the trial; they testified, *inter alia*, to original cost and capitalization of rentals (Pet. App. 21A-23A). In all events, the argument lacks merit.

The courts are in agreement that reproduction cost less depreciation is the least reliable indicium of market value. Both Courts of Appeals in which Wherry housing cases have been considered to date have so expressed themselves. Thus the court below stated (Pet. App. 4A):

> Defendants' [petitioners'] contention that the district court should be confined to a consideration of reproduction cost less depreciation is not well taken in this case, and such method generally is held to be one of the least reliable indicia of market value. * * *

The Court of Appeals for the Fifth Circuit has recently reversed and remanded a Wherry housing case

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the Federal Housing Administration as guarantor, and the mortgagee, the New York State Employees' Retirement System. By virtue of these agreements, the Air Force has been making payments of principal and interest on the mortgage indebtedness from May 1, 1957, the date of taking in the condemnation case.

[4] It is true, as petitioners note, that a number of Wherry Act cases are pending. Also, it is likely that one or more of these cases may raise issues of general importance. But it does not follow that this case is in that category.

on the ground that it was not proper to rely upon evidence of reproduction cost less depreciation. *United States v. Benning Housing Corp.*, C.A. 5, No. 17726, decided March 25, 1960, Appendix, *infra*, pp. 10-20. The same view has been widely expressed in other (non-Wherry housing) cases.[5]

Moreover, as the Court of Appeals points out in the *Benning* case, reproduction cost evidence ought not be considered in any instance without "a showing that substantial reproduction would be a reasonable business venture" (App., *infra*, p. 14). In the instant case, the testimony of witnesses on both sides was that no prudent person would invest the cost of reproduction of the projects, less depreciation (Def. App. 73a, 113a-114a; Pl. App. 55-56; cf. Pet. 25). As the District Court pointed out in its opinion (Pet. App. 15A, 16A), the valuation witnesses for the respondent rejected reproduction cost evidence as being representative of market value.

A further reason why reproduction cost evidence is inappropriate in Wherry Act cases is that those who operate Wherry projects have interests so limited and restricted that they cannot be compared to the usual unrestricted leasehold carved out of a fee. Because of

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[5] *E. g.*, *United States* v. *49,375 Square Feet of Land, etc.*, 92 F. Supp. 384, 388 (S.D. N.Y.), affirmed *sub nom. United States* v. *Tishman Realty & Const. Co.*, 193 F. 2d 180 (C.A. 2), certiorari denied, 343 U. S. 928; *United States* v. *44.00 Acres of Land, Etc.*, 234 F. 2d 410, 414 (C.A. 2); *Carlström* v. *United States*, C.A. 9, No. 16,128, decided Feb. 15, 1960, affirming *United States* v. *70.39 Acres of Land*, 164 F. Supp. 451, 488 (S.D. Cal.); *United States* v. *Savannah Shipyards*, 139 F. 2d 953, 956 (C.A. 5); *Jacksonville and Southeastern Ry. Co.* v. *Walsh*, 106 Ill. 253, 256-257; *Forest Preserve District* v. *Chilvers*, 344 Ill. 573, 578, 176 N. E. 720, 722.

the purpose of the Wherry Act to provide housing at rentals military personnel could afford to pay (the *quid pro quo* received by the government (App., *infra*, p. 18)) and because of the extraordinarily high percentage of the cost insured by the federal government, unusual restrictions and limitations were provided with respect to Wherry Act housing. See *Offutt Housing Co.* v. *Sarpy County*, 351 U.S. 253, and *United States* v. *Benning Housing Corp., et al.* (C.A. 5, No. 17726, decided March 25, 1960, Appendix, *infra*, pp. 10-20. As stated in the *Benning* case, "It is clear that the policy has consistently been one of allowing a return based upon original cost rather than reproduction. Rent increases were sanctioned only to offset rising operating costs and not to compensate for increased reproduction costs."[8]

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[8] The statement in the *Benning* case, that "The Act did not contemplate that sponsors would recover reproduction cost on a sharply rising market," can be fully documented. This is the answer to the claim that there is a conflict between the executive, legislative and judicial departments (Pet. 13), as well as to the assertions that Congress has determined that application of the usual rule of fair market value would be "improper and grossly unfair" (Pet. 12). The formula, setting a ceiling for a negotiated price, was expressly inapplicable if condemnation became necessary. Act of August 7, 1956, 70 Stat. 1091, 1111; H. Rept. No. 2363, 84th Cong., 2d Sess., 1956, pp. 45, 68; 102 Cong. Rec., pt. 11, p. 14468 (1956); S. Rept. No. 231, 85th Cong., 1st Sess. (1957), p. 23. The House Report says: "Your Committee desires to make it most clear that neither the Secretary of Defense, or his designee, nor the lessee are required to accept the price determined by the Commissioner under the formula contained in subsection (c) of the bill. If such price is rejected by either party it is expected that the Secretary of Defense, or his designee will proceed to acquire such project(s) through condemnation."

In view of petitioner's comment concerning the filing of a declaration of taking "without having made any offer for negotiations"

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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APRIL, 1960.

(Pet. 8), we note that, as a consequence of a tax ruling by officers of Champaign County and other developments, the United States decided to acquire the projects through condemnation as permitted by the Act of August 11, 1955, 69 Stat. 635, 652. The record is plain that representatives of the petitioners concurred in that decision, if in fact they did not suggest it (Pl. App. 66-68). Petitioners do not attack the taking for any alleged failure to conform to the requirements of the Act of August 7, 1956, 70 Stat. 1091, 1111.

APPENDIX

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 17726

UNITED STATES OF AMERICA, APPELLANT,

versus

BENNING HOUSING CORPORATION, ET AL., AND UNKNOWN OWNERS, APPELLEES

Appeal from the United States District Court for the Middle District of Georgia

(March 25, 1960.)

Before RIVES, Chief Judge, and TUTTLE and JONES, Circuit Judges.

RIVES, Chief Judge: This is a proceeding to establish just compensation for two "Wherry" housing projects condemned by the United States. The condemnees, Custer Road Terrace, Inc., and Benning Housing Corporation—corporations formed according to the requirements of the Wherry Act[1] expressly for the purpose of managing these projects—are beneficially owned by identical persons, thus making it possible to dispose of the case by one all-inclusive valuation.

The property condemned comprised leasehold estates in approximately 300 acres of land situated within the confines of Fort Benning, Georgia, together with the improvements thereon. Two separate seventy-five-year leases are involved: one, executed on March 3, 1950, and having approximately sixty-seven

[1] 63 Stat. 570 (1949), 12 U.S.C.A. §§1748, et seq.

and one-fourth years remaining as of December 31, 1957, the date of taking; and the second, executed on September 6, 1951, and having approximately sixty-eight and two-thirds years remaining as of that date. The improvements involved were quite substantial. Roughly speaking, they consisted of 370 brick residential buildings containing 800 family dwelling units, a commercial shopping center, various utility buildings, a network of paved streets and sidewalks, and complete water and sewage systems. Under the terms of the leases, titles to all improvements remained in the lessees and, upon expiration of the leases, the lessees had the privilege of removing those improvements. Any improvements not removed at that time, however, became the property of the United States.

The primary controversy at the trial centered about the method of valuation which was to be used in the determination of just compensation. The condemnees took the position that the proper measure of compensation for their interests was reproduction cost less depreciation. This position was predicated upon three contentions: that there was no established market and, consequently, no established market value for their property; that valuation by capitalization of income was inappropriate; and that the nature of the property condemned was such that the reproduction cost approach was peculiarly appropriate. The Government, on the other hand, took issue with each of these contentions. It offered, as evidence of market value, testimony relating to the sale of three Wherry housing projects,[2] and contended that these projects were comparable to those of the condemnees. Secondly, it contended that valuation by capitalization of income was

[2] The sales urged as comparable were those of Wherry housing projects at Barksdale, Louisiana, Quantico, Virginia, and Fort Devins, Massachusetts.

entirely appropriate to the property condemned. And, finally, it contended that the reproduction cost approach was entirely inappropriate and that evidence of reproduction cost should be excluded.

The district judge heard evidence relating to the alleged comparable sales at a special hearing prior to the trial and ruled that the sales were sufficiently comparable to warrant their admission into evidence. At the same time, however, he ruled that evidence of capitalization of income and reproduction cost was also admissible. Thus, the jury to which the case was eventually tried heard evidence relating to all three of these methods of valuation. A verdict was returned in favor of the condemnees in the amount of $2,171,487.[3] Since the Government had deposited only $941,000 prior to the trial, judgment was entered ordering payment of an additional $1,230,487 plus interest thereon from the date of taking.

The Government prosecutes this appeal, assigning as the primary ground therefor, the trial court's ruling that the jury could hear evidence of reproduction cost of the condemned property. Additional assignments relate to rulings made by the trial court on related, but comparatively incidental, questions.

An examination of the cases dealing with the admissibility of reproduction cost evidence reveals that, although the subject is clouded with considerable uncertainty, some pattern does emerge. Thus, it has almost uniformly been held that, absent some special showing, reproduction cost evidence is not admissible

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[3] This verdict was based upon the implied finding that the value of the projects was $8,135,492.53 for, by the terms of the taking, the United States assumed the balance of the mortgages on the projects in the amount of $5,964,005.53. For a discussion of the power of the United States to condemn a leasehold interest subject to a mortgage, see United States v. Certain Interests in Property, 7 Cir., 1959, 271 F.2d 379, 382-84.

in a condemnation proceeding.[4] This rule stems from a recognition of the fact that reproduction cost evidence almost invariably[5] tends to inflate valuation. This is so because the reproduction cost of a structure sets an absolute ceiling on the market price of that structure,[6] a ceiling which may not be, and most frequently is not, even approached in actual market negotiations. When this inherently inflationary attribute of reproduction cost evidence is considered in the light of the misleading exactitude which such evidence almost inevitably imparts to a jury unsophisticated in the niceties of economics, the justification for placing substantial safeguards upon its admission is apparent.

On the other hand, it is equally well recognized that in some cases, and upon a proper showing, the admission of reproduction cost evidence is justified, and even mandatory. Within this area of substantial agreement, there is, however, some disagreement. Thus, some courts hold that reproduction cost evidence is admissible only in those cases where the indicia of value under other methods are not available.[7] Other courts seem to treat this factor as largely irrelevant.[8] But, as to three other factors governing the admission of reproduction cost evidence, there is substantial, if not complete, unanimity. These are: (1) that the interest condemned must be one of complete ownership;[9] (2) that there must be a showing

[4] See generally, 2 Orgel, Valuation Under Eminent Domain §§188-199 (2nd ed., 1953).

[5] Id., at §188.

[6] Id., at §192.

[7] See, e.g., United States v. 2.4 Acres of Land, 7 Cir., 1943, 138 F. 2d 295.

[8] See, e.g., United States v. Wise, 4 Cir., 1942, 131 F. 2d 851.

[9] This follows naturally from the fact that reproduction cost is related to the value of the whole, if, indeed, it is related to value at all. Messer v. United States, 5 Cir., 1946, 157 F. 2d 793, provides

that substantial reproduction would be a reasonable business venture;[10] (3) that a proper allowance be made for depreciation.[11]

We will first deal with the Government's contention that reproduction cost evidence was not admissible because other indicia of value, i.e., comparable sales and income, were available. On this point, the Government relies upon the opinions of this Court in *Stephenson Brick Co.* v. *United States*[12] and *United States* v. *Savannah Shipyards*,[13] contending that these cases commit this Court to the view that reproduction cost evidence is not admissible where comparable sales evidence is available and are, therefore, entirely dispositive of the issue here presented.

An examination of those cases, however, reveals that this reliance is misplaced. The very most that they can properly be interpreted to stand for, and, indeed, even this is by way of dictum, is the proposition that where there is an established market value for the condemned property, reproduction cost evidence is inadmissible. The distinction which must be drawn is between a situation in which there is an established market value and one in which a few sales of comparable properties have occurred. In the latter situation,

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an ideal example of the sort of case reproduction cost could never be admitted. In that case, the condemnee was a mere licensee upon the lands condemned and was under an obligation to remove his improvements upon notice of termination of his license. This burden upon his right to free enjoyment of his structures detracted from the value of those structures to such an extent that, for that reason alone, the absence of any reasonably close relationship between value and reproduction cost was apparent.

[10] See United States v. Wise, supra, n. 8; 2 Orgel, op.cit. supra, n. 4, at § 196.

[11] See In re United States Commission to Appraise Washington Market Co. Property, D.C. Cir., 1923, 295 Fed. 950; 2 Orgel, op. cit. supra, n. 4, at §§ 196-97.

[12] 5 Cir., 1940, 110 F. 2d 360.

[13] 5 Cir., 1944, 139 F. 2d 953, reh. denied 140 F. 2d 863.

which is that involved in the present case, it cannot be said that a market value is established.[14] Isolated comparable sales, though themselves admissible as tending to show fair market value, are not sufficient to render reproduction cost evidence inadmissible in a case where admission is otherwise appropriate.

Thus, even if we assume that the dicta in *Stephenson Brick* and *Savannah Shipyards* accurately state the law of this Circuit with regard to the admissibility of reproduction cost evidence where a market value is established, the rule has no application here. Where a market value is not established, it is the primary responsibility of the trial court to determine whether reproduction cost evidence should be admitted as an aid to valuation. Here, the trial court ruled that it should and we cannot say that that decision was an abuse of discretion.

The Government's second contention raises a more serious difficulty. That contention, i.e., that reproduction cost evidence was inadmissible, because the condemnees' interest did not constitute complete ownership, is rested upon two separate grounds: first, that the Government was the real owner subject only to condemnees' leasehold; and, secondly, that condemnees' rights with respect to the property were limited by the fact that the projects were subject to rent control by the F.H.A. The condemnees, on the other hand, contend: first, that their leasehold interest is tantamount to complete ownership; and, secondly, that, even though the F.H.A. had the power to set rents, it could do so only in such a way as to guarantee the Wherry sponsor

[14] This propostion must, of course, be interpreted in the light of the facts of this case where the sales, though comparable, are far from identical. We do not mean to lay down any rule as to how many sales constitute the establishment of a market price. That will always ultimately depend upon the facts of the particular case and the characteristics of the market involved.

a fair return on the value of his property, and, therefore, that such a power in the F.H.A. could not diminish the value of the property.

As to the first ground urged by the Government, it seems clear that the condemnees must prevail. As pointed out above, both leases had in excess of sixty-five years yet to run as of the date of taking. Though the record indicates that it is entirely possible that the improvements here involved might outlast that period, the condemnees' interest is nevertheless not limited substantially by that fact. The present value of the Government's rights sixty-five years hence with respect to those improvements is negligible.[15]

In order to evaluate the contentions as to rent control, a brief survey of the background of these projects seems necessary. The projects were constructed under the aegis of the Wherry Act, which was enacted on August 8, 1949, in an attempt to relieve an acute shortage of housing which existed at that time at military installations throughout the country. The Act envisioned the construction of this needed housing by private builders and its provisions were consequently specifically designed to remove what appeared to its chief proponents to be the major impediments to such construction. The then current view of the problem was concisely expressed by Senator Wherry himself:

> "There are three requisites that must be provided in this legislation if it is to be successful: The program must be attractive to the builder or else you will get no construction; it must be attractive to the mortgage banker who supplies the money; the project must be made attractive to the Federal Housing Authority to enable it to set rental

[15] See Orgel, op.cit. supra, n. 4, at §122.

prices within the reach of families in the lower income brackets as well as in the higher brackets.'"[16]

The Wherry Act proposed to meet these requisites by providing for: (1) the elimination of land and acquisition costs by the leasing of land on military installations on long-term, irrevocable leases at nominal rentals; (2) a special form of mortgage insurance which avoided the problem created by the fact that ordinary F.H.A. mortgage insurance was unavailable because of the risk involved by reason of the location of the needed housing and the question as to the permanent nature of the military installations; and (3) F.H.A. control over the rents which could be charged for housing constructed under this plan.[17]

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[16] Quoted in S.Rep. No. 231, 85th Cong., 1st Sess., at p. 11.

[17] Insofar as the Wherry Act was designed to stimulate private construction of military housing, it was quite successful. Considerable amounts of such housing were erected on military installations throughout the country. In other aspects, however, the results of the program were less gratifying. Among the reasons for the dissatisfaction with the Wherry program were the following: (1) the probability of excessive profits in the early stages of the program; (2) the expected lack of sponsor interest in the later stages; (3) the fact that Wherry housing could not be assigned as "quarters" to military personnel; (4) the fact that the Wherry program permitted non-military personnel to live on military bases; and (5) the fact that movements of military personnel or the declining importance of military bases had led sometimes to high vacancy rates and frequent mortgage defaults. Review of Military Housing Programs, S.Rep. No. 231, p. 26, 85th Cong., 1st Sess., S.Rep. 404, p. 17, Cong.Doc.Ser. No. 11816; H.Rep. No. 913, p. 26, Cong.Doc.Ser. No. 11823, 84th Cong., 1st Sess. Consequently, on August 11, 1955, Congress enacted the Capehart Act, 69 Stat. 646 (1955), 42 U.S.C.A. § 1594, superseding the Wherry Act.

The Capehart Act provided that housing constructed on military installations after its enactment would be managed and operated by the Secretary of Defense instead of by the private builders as was the case under the Wherry Act. At the same time, it was provided that the Secretary of Defense could, in his discretion, acquire the existing Wherry housing projects. Where Capehart housing was

Considered in the light of the purposes of the Wherry Act, the proper resolution of the controversy seems clear. The condemnees' argument rests squarely upon a basic misconception of those purposes. For condemnees presuppose that the inducements offered by the Wherry Act to stimulate building, i.e., leases at nominal rentals and Government-insured mortgages, were outright gifts to the Wherry sponsors for which the Government would not, and, indeed, could not, exact a return.[18] Such is not the proper interpretation of that Act. These inducements were offered in return for low-cost housing. It is clear that the policy has consistently been one of allowing a return based upon original cost rather than reproduction. Rent increases were sanctioned only to offset rising operating costs and not to compensate for increased reproduction costs. The Act did not contemplate that sponsors would recover reproduction costs on a sharply rising market. And there was nothing unfair in its failure to do so. By insuring the mortgages on the projects, the Government assumed the risk of loss on a declining market. In such a situation, respect for the public interest prac-

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constructed at a military installation already being served by Wherry housing, acquisition of the Wherry housing was made mandatory. This latter provision was designed to protect Wherry sponsors from losses occasioned by competition with newer Capehart housing. The present case falls into this category, condemnation having been made necessary by the construction at Fort Benning of Capehart housing and the failure of negotiations between condemnees and the Government for a voluntary sale.

[18] It is this fact, i.e., the existence of the inducements, which completely distinguishes the Washington Market case, supra, n. 11, from the present case. The Washington Market Co. property was not subsidized as was that in this case. And, consequently, there were no limits upon the rents which the Company could charge for the property. Thus, the Washington Market case involves a situation where the requirement of complete ownership in the condemnee was met.

tically required that no benefit should accrue to the sponsors as a consequence of inflation.[19]

This conclusion is reinforced by the fact that the record is totally devoid of any unequivocal evidence that the project here involved would be reproduced by private investors at the risk of private capital. That reproduction would not occur under those circumstances in the vast majority of the cases is almost certain. Indeed, the Wherry Act was originally passed primarily because private investment was not providing such projects. We find nothing in the record to indicate that the situation at Fort Benning differs from this norm.

We conclude, therefore, that this is not a proper case for valuation on the basis of reproduction cost.[20] This means, of course, that the case must be tried on the basis of comparable sales, capitalization of income and original cost. Though it is apparent in a case such as this that the problem of valuation on the basis of these factors alone is a difficult one, that is unavoidable. The admission of reproduction cost evidence, though perhaps making it easier to reach *some* solution, only made the *proper* solution more difficult.

Since the case is to be tried again, we find it unnec-

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[19] This conclusion does not conflict with the holding of the Supreme Court in Offut Housing Co. v. Sarpy, 1956, 351 U.S. 253, relied upon by the condemnees. The Offut Housing case held merely that a Wherry sponsor was subject to taxation by the state in which his project was located on the basis of the full value of that project. That holding is entirely without bearing upon the question presented here, i.e., whether, and under what conditions, the value of such a project may be measured in terms of its current reproduction cost.

[20] We therefore find it unnecessary to pass upon the objections made by the Government to condemnees' showing with respect to depreciation. This question is not necessary for the success of this appeal and, in view of our holding, cannot arise again upon a second trial.

essary to comment upon many of the other errors urged by the Government. In the interest of sound judicial administration, however, it does seem wise to point out one error which occurred at the last trial and which might occur again. Over the Government's objection, the condemnees were permitted to introduce evidence related to a purported rent increase as to this housing which allegedly was instituted by the Government immediately after it took the projects. This purported increase was based upon the assignment of some of the housing to military personnel as Government quarters and the consequent forfeiture of the quarters allowance of such personnel. Such an arrangement does not constitute a rent increase in any proper sense and no testimony should have been admitted relating to it.[21]

REVERSED AND REMANDED.

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[21] This follows from the very nature of the quarters allowance given to military personnel. The allowance is the same throughout the country, like Government travel allowances, and varies, not according to space or type of property (house or apartment) occupied, but according to the rank and the dependency situation of the particular personnel involved. Thus, the allowance is totally unrelated to rental value. To hold otherwise, is to adopt the anomalous position that the very same apartment may have one rental value if occupied by a colonel and a far lesser value if occupied by a lieutenant.

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IN THE

Supreme Court of the United States

October Term, 1959

No. 808

CERTAIN INTERESTS IN PROPERTY IN CHAMPAIGN COUNTY, STATE OF ILLINOIS; CHANUTE GARDENS CORPORATION and CHANUTE APARTMENTS CORPORATION,

Petitioners,

v.

UNITED STATES OF AMERICA.

ON PETITION FOR A WRIT OF CERTIORARI TO UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF OF PETITIONERS.

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REPLY BRIEF OF PETITIONERS

This Brief is submitted in reply to the Brief for the United States in opposition to our petition for certiorari.

I. The *Benning* Case.

The decision of the Fifth Circuit in *United States* v. *Benning Housing Corp.* (C. A. 5, No. 17726, decided March 25, 1960), printed in full in the Government's Brief, furnishes added reasons for the granting of certiorari here.

A. The Court in *Benning*, rejecting reproduction cost as an element of value in Wherry project cases, held that even where there were a few isolated comparable sales,[1]

[1] One of the sales held comparable in *Benning* was of the Wherry project at Fort Devins, Mass. (see fn. 2 to opinion). But it was this same sale which was held non-comparable by the courts below in the case at bar (see our Pet. for Cert., p. 15a), it being a sale of stock in a corporation owning a Wherry project. (*Id.* at p. 14, fn. 4.) We suspect that the other two sales mentioned in *Benning* were of a similarly inadmissible nature.

(missing here), it did not constitute a market. The Court in *Benning* carefully avoided using the standard of market value used by the Court below in the case at bar.[2] Moreover, *Benning* rejected reproduction cost not on the ground that the property was not sufficiently unique (as did the Court below here), but for entirely different reasons.

B. *Benning* contributes a fifth view to four already-existing different views on the treatment of reproduction cost in cases where there is no established market value and where property is taken to continue its same governmental use.

(i) Both *Benning* and the decision below conflict squarely with *In re United States Commission to Appraise*

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[2] The Government contends that the conflict between the Executive, Legislative and Judicial Departments can be resolved on the basis that the Wherry Act did not contemplate its sponsors would cover reproduction cost, relying upon *Benning*. However, it would seem that *Benning* ignored the later Capehart Act, which provided for a maximum negotiated price of a reproduction cost less depreciation. Though this negotiated price was of course not necessarily applicable in condemnation proceedings, the fact does remain that Congress and the Executive Departments have determined that the application of the usual rule of fair market value would be an "improper and grossly unfair" measure of just compensation for Wherry projects, and that this "improper and grossly unfair" rule was used below in the case at bar.

The quest for a market value below resulted in an entirely disproportionate weight being given to the figure arrived at for capitalization of rents. The final valuation figure of the Court was $7,100,000—only 2% above the court-found capitalized value ($6,950,000)—but some 21% less than net reproduction cost ($8,750,000) or some 23% less than original reasonable cost ($9,200,000). (And this for properties which were in even better condition than when originally built!)

It is thus apparent that the Trial Court relied almost entirely if not exclusively upon capitalization of rents. Had it been seeking true value, or sound value, rather than a non-existent market value, it is patent that the same result would not have followed, but that more weight would have been given to other elements besides capitalization of rents. See pet. for cert., p. 22, fn. 11.

Washington Market Co. Property, 295 Fed. 950 (D. C. Cir., 1924), *pet. for cert. dismissed on Government's motion*, 265 U. S. 598. While *Benning* seeks to distinguish *Washington Market* (which placed *exclusive* reliance on reproduction cost) on the theory that it did not involve leases at nominal rentals and Government-insured mortgages, such a consideration is entirely irrelevant to the *ratio decedendi* of *Washington Market*, where reproduction cost was used as the exclusive test (even though there was evidence of market value—see 295 Fed. at 959), solely and simply because the property was taken to continue its use and because market value therefore did not represent just compensation. That reproduction cost is not the measure of value solely because of *ab initio* inducements seems to be a non-sequitur. The test of *Washington Market* is whether the property was taken to continue its use.

(ii) In relying on the so-called inducements and on rent control as the reasons for rejecting reproduction cost, *Benning* squarely conflicts with *Thayer-West Point Hotel Co.* v. *United States*, 64 F. Supp. 565 (Ct. Cls. 1946), modified on other grounds, 329 U. S. 585. In *Thayer*, even greater inducements were present than in the case at bar—the lessee there paid a ground rent of $1 for the entire 50 year term (R. 6). And rents were controlled arbitrarily by the military. Yet neither the Solicitor General nor this Court saw any reason to object to main reliance being placed on reproduction cost.

(iii) *Benning* concedes there was no established market value. Where there is "no open market and no comparable sales to serve as proof * * * of market value", the Second Circuit has held that "under such conditions * * *, reproduction cost less proper depreciation may be deemed a reliable indication of the *minimum* value." *The Hisko*, 54 F. 2d 540, 541 (2d Cir., 1931) (emphasis supplied). *Benning* holds that under such circumstances, reproduction cost sets a *maximum* value—and cannot even be considered.

C. The decisions below here held that, in ascertaining capitalized value, the actual rentals—based upon estimated anticipated cost rather than actual original cost—must be capitalized. We contended unsuccessfully that we were entitled to have rentals capitalized which were based on original cost. *Benning* accepts our contention, and thus conflicts with the decisions below.[3]

D. *Benning* holds that valuation must be based upon comparable sales, capitalization of income, and original cost. In the case at bar, there were no comparable sales, and there was no actual consideration given to original cost (see fn. 2 *supra*). Had the rents allowable under *Benning* been capitalized instead of the illegal rentals which were capitalized, a capitalized value of some $9,200,000 and an original cost of the same amount would have been the only two factors considered in determining value; the award here of $7,100,000 would then have been inconceivable.

E. Another point of departure of *Benning* is its predication of the right to recover reproduction cost upon complete ownership, reasoning that a long-term lessee who possesses the full value of the fee is in the same position as a licensee who must remove his improvements upon notice (fn. 9, *Benning*). Not only is the analogy altogether unconvincing, but it simply does not follow that one subject to reasonable rent regulation who has been granted inducements for making a bargain is *ipso facto* deprived of complete ownership. Under this novel theory, every property subject to federal, state or municipal rent regulation, or which has been built with public assistance, is thereby not completely owned and reproduction cost can not be even an element in its valuation.

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[3] In our case, since there was only a one-half of one per cent variation between original cost ($9,200,000) and reproduction cost ($9,250,000), rentals based upon original cost would have yielded a capitalized value closely approximating reproduction cost. The rentals used by the courts below resulted in a capitalized value of $6,950,000.

F. In using capitalized value as a test for Wherry projects, and in holding that increased construction costs on a sharply rising market cannot be considered, *Benning* necessarily falls into the same error as the Courts below and the Government's witnesses: that the Wherry investor loses a substantial part of his investment immediately upon completion.[4]

The illogical conclusion demonstrates the fallacy of its premises, a fallacy due to the resort to an outside market to get a capitalization rate (Pet. App. 112a), when there is no market to provide a proper capitalization rate, and when the property was specifically constructed on a non-marketable basis.

But in any event, the alarm of inflation cannot be rung here, for the increase in reproduction cost over original cost was less than 3% in the case at bar. Inflation cannot explain the valuation here at some 23% less than original cost or some 21% less than even net reproduction cost.

G. *Benning* requires a showing that "substantial reproduction would be a reasonable business venture" before reproduction cost be considered. What this means is that the property must possess present utility and be not obsolete—which is the precise holding of the case upon which *Benning* relies for this proposition (*United States* v. *Wise*, 131 F. 2d 851 (4th Cir., 1942)). Here the Government has taken the property to continue the same use, and has built substantially similar housing at the same base at greater cost; and only the Government could build such property. See also, Petition for Certiorari in the case at bar, pages 24-25. We amply meet this condition of *Benning*.

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[4] Government witnesses so testified. Our point is made by this example: assume an estimated and actual original cost of $1,000,000, with the 6½% return negotiated here yielding a $65,000 return. Capitalize this at the increased outside market rate of 8%, and the resulting value is $812,500. Thus, the value of the project under the theory in *Benning* has declined some 18¾% immediately upon its construction.

II. The "Subject to the Mortgage" Problem.

Government's Brief itself notes that whereas the taking occurred on May 1, 1957, the petitioners were not released from their obligations on the mortgage notes until April 14, 1958 (pp. 5-6). Thus, for almost a year, when twelve monthly mortgage payments became due, petitioners were liable for payment on the mortgage notes under the theory of the Court below that petitioners' interests were taken subject to the mortgage.

Respectfully submitted,

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